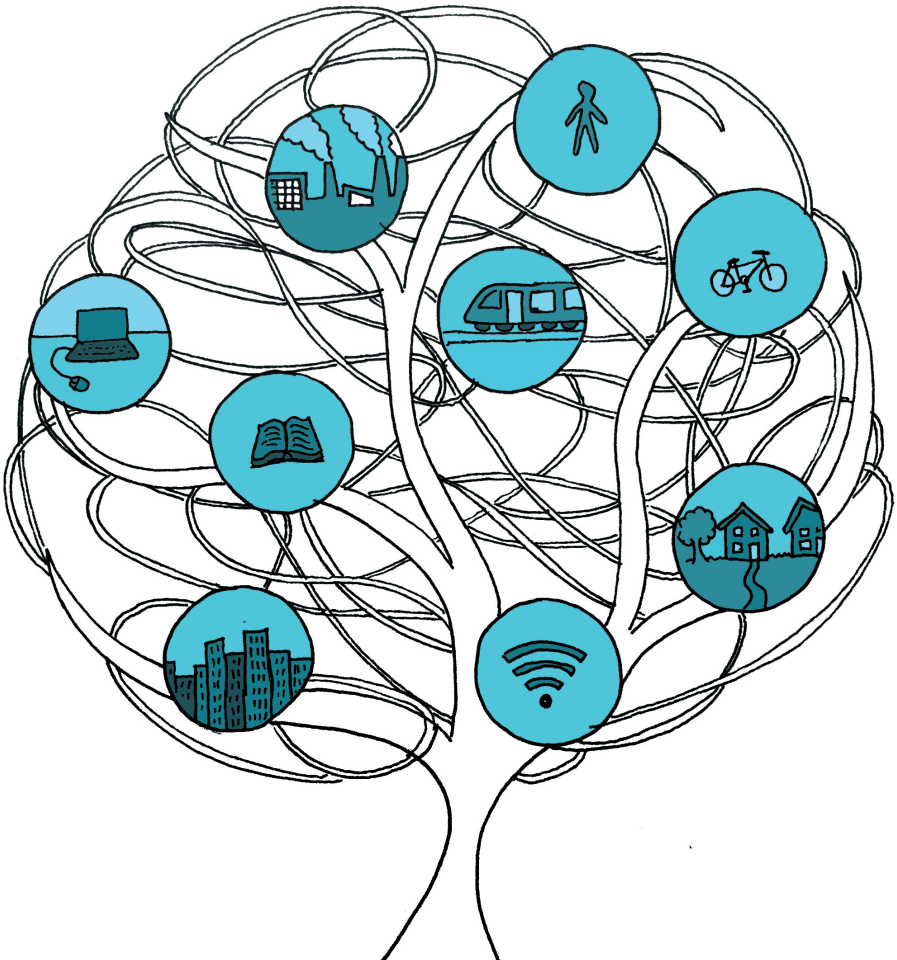


# SMARTER NOT HARDER

HOW DEVOLUTION CAN MAKE  
PLACES MORE PRODUCTIVE

Jessica Studdert



New Local Government Network (NLGN) is an independent think tank that seeks to transform public services, revitalise local political leadership and empower local communities. NLGN is publishing this report as part of its programme of research and innovative policy projects, which we hope will be of use to policy makers and practitioners. The views expressed are however those of the authors and not necessarily those of NLGN.

© NLGN July 2016

All rights reserved

Published by NLGN

Hub Westminster, 80 Haymarket

1st Floor, New Zealand House

London, SW1Y 4TE

Tel 020 7148 4601 . Email [info@nlgn.org.uk](mailto:info@nlgn.org.uk) . [www.nlgn.org.uk](http://www.nlgn.org.uk)

# CONTENTS

ACKNOWLEDGEMENTS	4
FOREWORD	5
1 INTRODUCTION	7
2 PRODUCTIVITY: WHY LOCAL?	13
3 TOWARDS A FRAMEWORK FOR LOCAL PRODUCTIVITY	20
4 PRODUCTIVE PEOPLE	29
5 PRODUCTIVE ENTERPRISE	38
6 PRODUCTIVE PLACES	50
7 LOCAL GOVERNANCE: FROM STRUCTURES TO INCENTIVES	56
CONCLUSION	65
OUR PARTNERS	66

# ACKNOWLEDGEMENTS

Thanks are due to the many individuals and organisations who gave their time and insight into the development of this report, including all who participated in the roundtable and the workshop held as part of the research. In particular, I would like to thank all those who took the time to be interviewed at Sheffield City Council and Sheffield City Region, Newcastle City Council, Suffolk County Council, Norfolk County Council, East Suffolk District Council, Babergh District Council, Mid Suffolk District Council, North East LEP and New Anglia LEP. In addition, I am grateful to Chris Pope, New Economy and Stephen Gaskell, Southwark Council for sharing their expertise during the development of the report.

My colleagues at NLGN have also contributed greatly to this work and I thank Simon Parker, Emma Burnell, Vivek Bhardwaj, Claire Mansfield, Rebecca Creamer, Abby Gilbert, Shahnaz Yasmin and Jane Swindley for their support. In particular I am grateful to Andrew Hoolachan, Sarah Stopforth and Kathinka Lyche, who all provided valuable research support.

Finally, I would like to thank iMPower and Kier for making this report possible, and Liam Booth-Smith, Martin Cresswell and Matthew Bull for their support.

Any mistakes or omissions in the report are my own.

**JESSICA STUDDERT**

NLGN

# SMARTER NOT HARDER

HOW DEVOLUTION CAN MAKE  
PLACES MORE PRODUCTIVE

Jessica Studdert

# FOREWORD

**Local government's role is changing. A decade ago, councils were the parochial branch of the welfare state, incentivised and inspected to ensure that they delivered ever improving public services. As we head towards the 2020s, it is becoming increasingly clear that the sector's key role will be to drive growth. If we can raise levels of local prosperity, we can reduce demand for public services while increasing financial sustainability. At some point, a new equilibrium will be struck between budgets and need.**

But there are better and worse kinds of growth. It is entirely possible to grow your business rate base by cutting taxes and attracting out of town warehouses stuffed full of staff in minimum wage jobs. Taking this low road to growth might provide a short-term sugar rush of activity, but it will be followed by the crushing reality of an economy built on the cheap. Ultimately, this strategy is not going to take people out of poverty and leave them proudly independent of state support.

The high road – and the only way to secure long-term success – is to focus on productivity. Councils must help to improve the output of every hour worked in their local economies, ensuring that living standards rise in the long-run.

We do not talk much about the local role in productivity: most economists assume that the drivers of productive growth are national or even international in character. And yet this report shows that there is in fact a distinctly local angle to the UK's low productivity puzzle.

A generation of over-weening centralism has robbed towns and cities of the power to shape critical transport links, skills policy, business support and fiscal levers they need to support their economies. Devolution is slowly starting to return some of the policy tools that councils need to improve productivity, but we need to go much further.

Britain's decision to leave the EU – made just as this report was going to press – only makes it more urgent that we improve our local economic resilience to weather possible storms ahead.

Evidence for the impact of local productivity strategies is limited, but evidence it won't work is non-existent. Academic economists provide few pointers to councils on how to improve productivity and we cannot wait for them to produce the goods: the problem is here and now. Instead, we offer a framework for action based on the best available data and our own examination of existing practice. This is a moment for experimentation, and I hope this report will give councils the tools they need to get started.

**SIMON PARKER**

Director, NLGN

# 1 INTRODUCTION

**The UK is a productivity laggard. The effectiveness with which our businesses convert resources into goods and services is historically poor by international standards, and has flatlined since the recession in 2008. The precise causes of this trend are mysterious and contested by economists, many of whom describe it as a ‘puzzle’. But there is a broad consensus that improving the UK’s productivity is one of the primary economic challenges of our time. This matters hugely for the country’s future: by increasing the value of our output in relation to input, productivity drives up economic growth, improves living standards and provides the resources the country needs to maintain its public services.**

For most economists, productivity is best analysed at the level of nations and sectors. But there is a neglected spatial dimension. Important elements of the policy levers that have the greatest influence over productivity – skills, innovation and infrastructure – are increasingly being devolved to city regions. The Government’s 2015 productivity plan<sup>1</sup> sets out a critical role for local government in solving the productivity puzzle. And it is becoming increasingly clear that different parts of the country face different kinds of productivity challenges, and that locally-tailored responses may be necessary.

Despite these facts, the Government’s devolution agenda is not yet explicitly driven by the need to boost productivity. In this report, we define a clear role for cities and shires in boosting productivity, and set out concrete steps that practitioners can take to improve their local economies. Our argument is that:

1. Different places face different productivity challenges.
2. Local areas’ abilities to respond to the productivity puzzle is highly constrained by central policy control.
3. The Government’s approach to devolution must therefore create policy and financial levers to drive local productivity growth.

---

<sup>1</sup> HM Treasury (2015) *Fixing the Foundations: Creating a More Prosperous Nation*.

It is important to note that productivity is not the same thing as Gross Value Added (GVA) growth overall. In the short-term at least, it is possible to grow your economy simply by expanding low productivity industries – expanding the volume, but not necessarily the value, of outputs. In the long-run, economies based on cheap labour and low skills will not make anyone richer or happier. Neither does the fact that greater productivity makes us wealthier guarantee that our economy will be inclusive. In fact, strategies designed to grow the cake of local economies may be in tension with strategies designed to share the cake fairly between residents.

But without productivity and the prosperity it generates, most of our wider social, economic and environmental priorities become far more difficult to achieve. Places are held back by weak productivity. Unless we can overturn low core labour and sector productivity, this will be a persistent drag on local economies which perpetuates lack of opportunity. Economic uncertainty following the vote to leave the EU makes it more urgent that we address the structural fundamentals of our economy. It needs to work smarter, not harder.

For the purposes of this report, a tight focus on local productivity is necessary because the extent to which local authorities are enabling, or have the powers to enable, productivity gains is variable. Research for this report<sup>2</sup> found that councils recognise the challenges and have the appetite to address the fallout of weak productivity growth. But it also established that the policy levers available to cities and shires are weak, and need to be strengthened.

The report recommends a shift in the Government's current focus on creating new structures to reflect business interests, to one which focusses on gearing stronger incentives to drive productivity in places. We recommend changes to the existing local fiscal framework, including:

- **Business rates retention should involve full flexibility to drive productivity**, including the ability to set rates locally and adapt them to incentivise sector-specific growth. The proposed additional two per cent 'infrastructure premium' should be replaced with a 'productivity

---

<sup>2</sup> Our research methodology included a roundtable discussion and a simulated game workshop devising a productivity strategy for a fictional combined authority with senior local government officers. We also conducted a series of interviews with leading local government and LEP representatives in Sheffield and Sheffield City Region; Newcastle and the North East; and Suffolk and Norfolk.

premium', as it may be that some areas would see more productivity benefit from other investments than infrastructure alone, such as in human capital.

- **To create incentives to drive productivity locally, a third of corporation tax generated in England, up to £12.1 billion, should be devolved to city and county regions.** Business rates are levied on floor space rather than productive business output, so devolving an element of the tax levied on business profits to combined authorities will enable places to capture some of the rewards of productive growth. This will provide a stronger incentive to create functional local economies as healthy environments in which businesses can set up, innovate and scale-up. The measure would be designed to create a virtuous cycle of future investment to generate further productivity. This would bring the local fiscal framework in England in line with international peers where an element of direct local taxation on business profits or activity is the norm.

This report first sets out a local productivity framework focussing on three areas – people, enterprise and place – and proposes local and national policy measures aimed at stimulating productivity locally.

## FOR PRODUCTIVE PEOPLE

- **Local productivity plans should support three aims: labour market participation; in-work progression; and attracting and retaining highly skilled workers.** This must be based on a clear understanding of employers' skills requirements and brokerage with providers to ensure provision meets identified productivity gaps in sectors.
- **Devolution should create a single point of local accountability for the entire employment and skills system across a place,** including over 16-18 further education budgets, the apprenticeship levy and local Jobcentre Plus employment advice services. This would focus fragmented resources and stakeholders on a more impactful whole systems approach linked to local economies. This would drive productivity by developing human capital and more effectively matching workers with jobs to reduce skills gaps.

## FOR PRODUCTIVE ENTERPRISE

- **Local productivity plans should develop specific sector specialisms and integrate policy to support local innovation ecosystems with a competitive advantage.** Businesses should be supported to scale up across the spectrum with evidence-led, targeted interventions. Sustained horizontal collaboration across places should be developed between local and combined authorities, Local Enterprise Partnerships (LEPs) and higher education institutions to create stronger anchors, including joint investment funds, from which to crowd in private sector investment.
- **The government's innovation strategy should shift from a national sectoral model with little geographical focus to a place-based approach.** This means working directly with places to identify strengths, supporting horizontal collaboration and aligning national investment into city and county region innovation funds. This would mean places can build innovation capacity around sector specialisms and maximise the benefit of investment through associated infrastructure and business support planning for supply chains. UKTI should establish joint accountability with city and county regions to develop bespoke plans for boosting exports of innovative goods and services and build sub-regional international links.

## FOR PRODUCTIVE PLACES

- **New powers through devolution deals mean that combined authorities must now develop infrastructure and connectivity plans focussed on driving productivity.** This will involve creating the conditions for clustering and agglomeration benefits for businesses and ensuring a pipeline of housing and transport connectivity projects meets emerging demand and connects workers with economic opportunity. Local strategies should also focus on developing stronger cultural and place identity to attract and retain workers and business inward investment.

- **Future devolution should be informed by the need to drive productivity and unblock locally-identified barriers to productive growth.** This would involve a more bespoke approach to future deals that devolve powers which enable productivity plans to meet their potential, for example by removing barriers to delivering affordable housing where this is an identified blocker on productivity. The Government should seek to embed long-term certainty through devolution, including by moving to five year capital budget allocations for infrastructure.

By raising the role of productivity as a target of local economic strategies, we hope to focus on how local government can continue to play an active role in driving prosperity for its citizens. This involves not just a focus on a local productivity framework to underpin local strategies, but also a priority for national policy and devolution to remove constraints on local government's ability to drive growth and create new levers to boost productivity.

We hope this report plays a strong part in the wider movement to reverse decades of centralisation and rebalance our economy in the long term.

## 2 PRODUCTIVITY: WHY LOCAL?

“PRODUCTIVITY ISN’T EVERYTHING, BUT IN THE LONG RUN IT IS ALMOST EVERYTHING. A COUNTRY’S ABILITY TO IMPROVE ITS STANDARD OF LIVING OVER TIME DEPENDS ALMOST ENTIRELY ON ITS ABILITY TO RAISE ITS OUTPUT PER WORKER.”<sup>3</sup>

**PAUL KRUGMAN**

**Productivity is about working smarter, rather than harder. Economies have developed through the centuries because of their ability to generate better outputs by more effectively combining capital and labour inputs. This is influenced by new ideas, technological innovations and improved business models catalysing change and progression.**<sup>4</sup>

The UK is currently in the grip of a productivity slowdown. Since 1997 the average rate of growth in Gross Domestic Product (GDP) per hour worked, a key measure of national productivity, was two per cent a year (see Figure 1). After 2008 this fell off and has remained flat since, leaving a gap between projections based on previous growth trends and the actual of over 15 per cent. The G7 average recovery has been stronger. This situation compounds our historical status as a productivity “laggard” compared to international peers<sup>5</sup> (see Figure 2).

Our economic recovery since 2008 has relied on jobs growth, rather than productivity growth. There will be a ceiling on returns from further jobs expansion alone: working age employment is at record high levels and unemployment is at a ten year low of 5.1 per cent.<sup>6</sup> The composition of our growth matters increasingly: as our population ages, future economic resilience will be reliant on our ability to increase productivity across sectors.

---

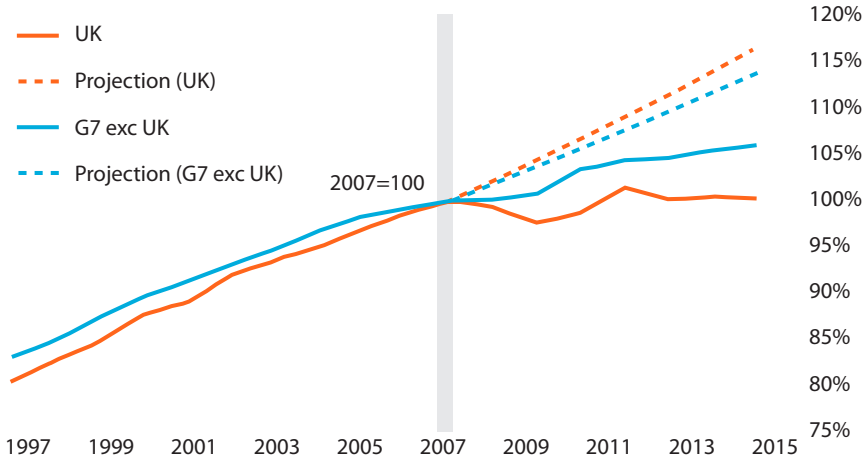
<sup>3</sup> Krugman, P. (1994), *The Age of Diminished Expectations*, The MIT Press.

<sup>4</sup> OECD (2015), *The Future of Productivity*.

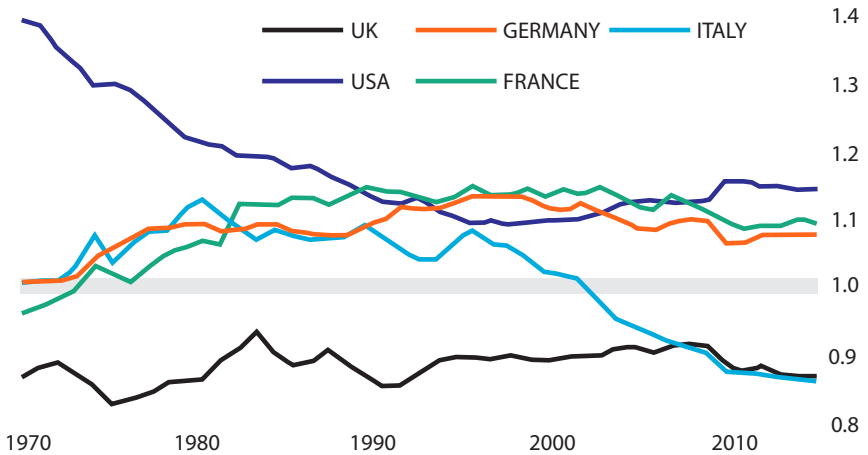
<sup>5</sup> Jones, R. (2016), *Innovation, Research and the UK’s Productivity Crisis*, Speri Paper No. 28.

<sup>6</sup> Thompson, S. et al (2016), *Boosting Britain’s Low-Wage Sectors: A Strategy for Productivity, Innovation and Growth*, Ippr.

**FIGURE 1** CONSTANT PRICE GDP PER HOUR WORKED, ACTUALS AND PROJECTIONS<sup>7</sup>



**FIGURE 2** LABOUR PRODUCTIVITY RELATIVE TO THE G7 AVERAGE<sup>8</sup>

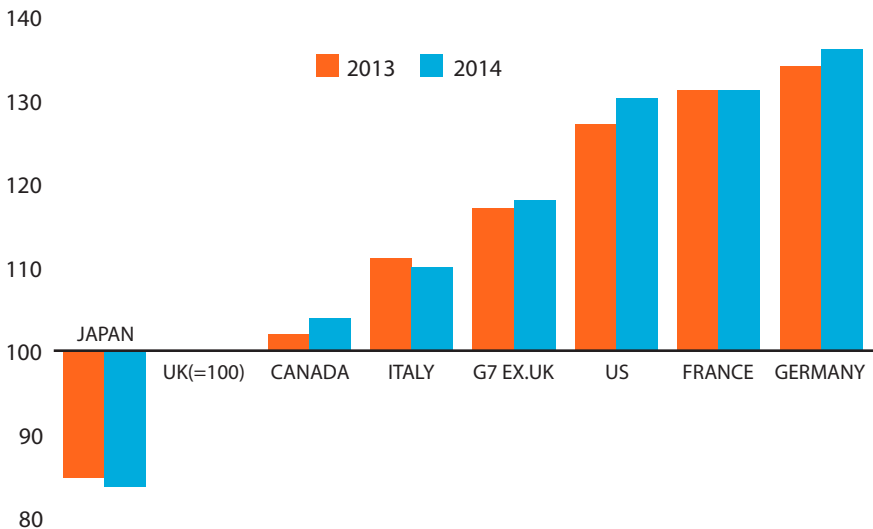


<sup>7</sup> Source: Office for National Statistics (2016), Statistical Bulletin: International Comparisons of productivity – final estimates, 2014.

<sup>8</sup> Source: OECD data, presented in Jones, R. (2016), *Innovation, Research and the UK's Productivity Crisis*, Speri Paper No. 28.

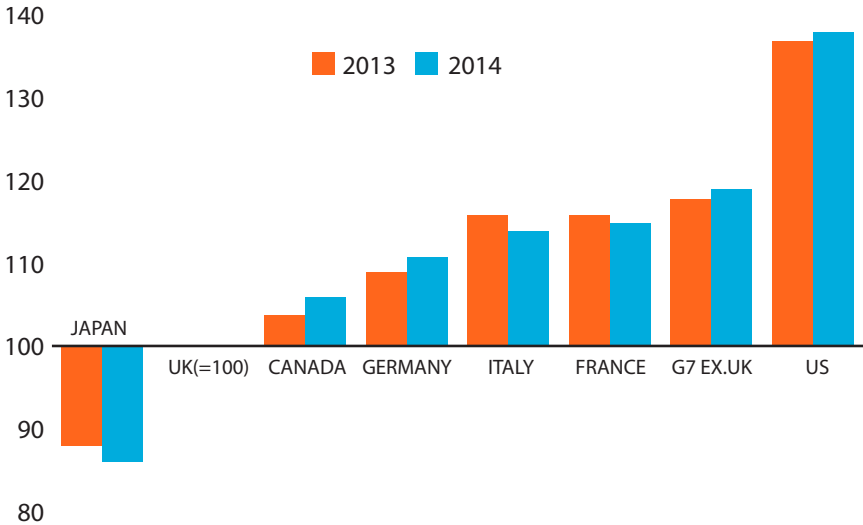
So our productivity puzzle must be solved. Its causes have been analysed and investigated by economists, but not fully explained. All countries experienced a productivity shortfall after 2008, but why has the recovery of the G7 average been stronger and quicker than the UK's (see Figure 1)? Why is our current output per hour and per worker so significantly behind that of the G7 average – 18 and 19 percentage points respectively (see Figures 3 and 4)? And why, since the 1970s, has our national productivity rate been so consistently behind that of our closest international peers, notably the USA, France and Germany (see Figure 2)?

**FIGURE 3** GDP PER HOUR WORKED, G7 COUNTRIES<sup>9</sup>



<sup>9</sup> Source: Office for National Statistics (2016), Statistical Bulletin: *International Comparisons of Productivity – Final Estimates*, 2014.

**FIGURE 4** GDP PER WORKER, G7 COUNTRIES<sup>10</sup>



Although explanations diverge, most economists agree that our productivity puzzle is not due to a single factor, but that it is caused by a combination of cyclical and structural effects.<sup>11</sup>

Cyclical, or demand-side explanations, focus on behaviours of firms and workers since the crash to explain the lag:<sup>12</sup>

- ‘Labour hoarding’ might account for the lag whereby workers were retained despite a fall in demand for products, on the expectation that demand would pick up and to avoid the cost of firing and rehiring, but which led to an under-utilisation of labour.<sup>13</sup>
- ‘Capital shallowing’ in relation to labour might have occurred whereby the fall in real wages and rise in costs of capital means that it has

<sup>10</sup> Ibid.

<sup>11</sup> Valero, A (2015), ‘Productivity: The Elephant in the Room’, LSE Comment.

<sup>12</sup> For a good discussion of these, see Dolphin, T. and Hatfield, A. (2015) *The Missing Pieces: Solving Britain’s Productivity Puzzle*, Ippr.

<sup>13</sup> Barnett, A. et al (2014) *The UK Productivity Puzzle*, Bank of England Quarterly Bulletin 2014 Q2.

become preferable for firms to hire workers than invest in capital that can drive productivity gains, such as technology, process or machinery.<sup>14</sup>

These explanations tend to assume that there is spare capacity in the economy which has potential to contribute to productivity gains if the right investment is made in the workforce or capital.

Structural, or supply-side explanations, focus on factors related to the allocation of resources in the economy:

- Strong job growth in relatively low value-added, low paid sectors of the economy is estimated to account for half the weakness in UK productivity growth.<sup>15</sup>
- The role of skills in contributing to economic performance through fostering innovation and knowledge transfer is recognised,<sup>16</sup> and the lag between employer demand and supply for skills recognised as a barrier to productive growth.<sup>17</sup>
- Citing the role of technological and organisational innovation in productivity growth, some analysis highlights the UK's long-term record of lower spending on Research and Development (R&D) compared to other economies.<sup>18</sup>
- Inadequacies in UK infrastructure have been identified as creating high levels of policy instability and risk for investors, which are also related to a high cost of capital and problems raising finance for the private sector.<sup>19</sup>

---

<sup>14</sup> Pessoa, J.P. and Van Reenan, J. (2014), cited in Dolphin, T. and Hatfield, A. (2015) *The Missing Pieces: Solving Britain's Productivity Puzzle*, lppr.

<sup>15</sup> Dolphin, T. and Hatfield, A. (2015) *The Missing Pieces: Solving Britain's Productivity Puzzle*, lppr.

<sup>16</sup> House of Commons Business, Innovation and Skills and Education Committees (2015) *Education, Skills and Productivity: Commissioned Research*.

<sup>17</sup> OECD (2015), *The Future of Productivity*.

<sup>18</sup> Jones, R. (2016) *Innovation, Research and the UK's productivity crisis*, Spери Paper No. 28.

<sup>19</sup> Valero, A (2015) 'The UK needs a clear growth strategy to avoid short-term solutions to the productivity puzzle', LSE Business Review.

Yet most explanations of the productivity puzzle tend to focus solely on national or sectoral factors. The key enablers of productivity growth – skills and jobs, firm behaviour and innovation, or infrastructure – are generally seen on a purely national level or by sector. But it is becoming increasingly clear that there is an important local angle to the problem.

## WHY IS A LOCAL DIMENSION TO PRODUCTIVITY IMPORTANT?

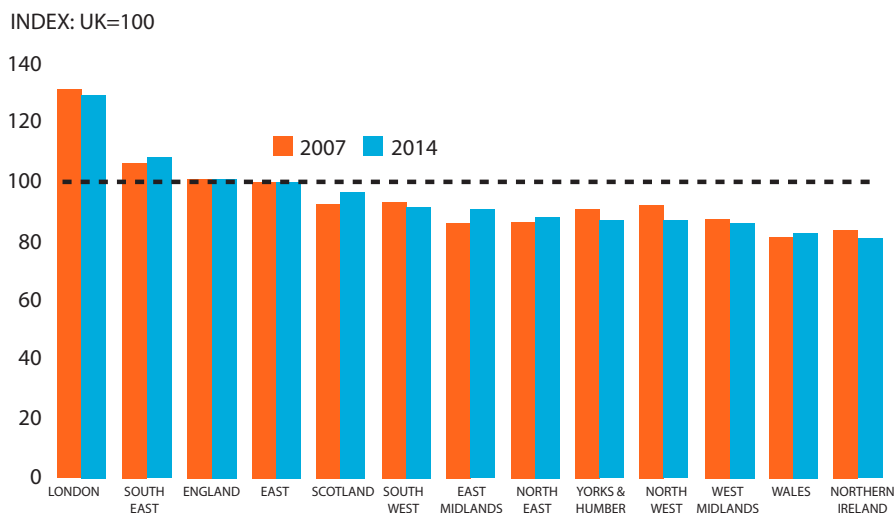
Given the complexity and interconnectedness of factors causing the UK's lagging productivity, on one level it could be argued that it is self-evident that the local dimension is at least as important as other factors. Why wouldn't the role of local economies, and the different challenges and opportunities that exist within them, be an essential part of the overall picture? But there are a series of specific reasons why it is essential that the local dimension to productivity is fully acknowledged, and why it is increasingly urgent that we understand it and shape policy responses accordingly.

**Spatially, productivity challenges play out differently.** The overall national productivity figures do not fully reveal the significant disparities between and within regions. As Figure 5 demonstrates, only London and the South East perform higher than the national average, the East is equivalent to national average, and other regions perform below: a scenario similar today to that before the recession in 2008. Analysis suggests that in terms of the disparity between London and the rest of the country, it is not just that London is over-productive, but that other cities are also separately under-productive in comparison to European counterparts of similar size, density and agglomeration.<sup>20</sup>

---

<sup>20</sup> Core Cities (2016) *Core Cities, Delivering Place-based Productivity*.

**FIGURE 5** UK REGIONAL PRODUCTIVITY, NOMINAL GVA PER HOUR WORKED<sup>21</sup>



There is better insight into the links between the UK's highly centralised model of governance and our low and unbalanced national growth.<sup>22</sup> City regions have increasingly been identified as drivers of regional investment, productivity and sustainable growth in a knowledge-driven, global economy in which agglomeration effects are crucial.<sup>23</sup> The range of barriers to generating rural productivity are also increasingly understood, informing the need for more effective responses.<sup>24</sup>

**International evidence has established links between the extent of decentralisation and productive growth.** Comparative analysis conducted by the OECD demonstrates that the relationship between fiscal decentralisation and GDP per capita, productivity or human capital

<sup>21</sup> House of Commons Library (2016) *Productivity in the UK*; Briefing Paper No. 06492.

<sup>22</sup> See for example Lord Heseltine Review (2012) *No Stone Unturned: In pursuit of growth*; Cox, E. et al (2014) *Decentralisation Decade*, Ippr

<sup>23</sup> RSA City Growth Commission (2014) *Unleashing Metro Growth*.

<sup>24</sup> DEFRA (2015) *Towards a one nation economy: A 10 point plan for boosting productivity in rural areas*.

is 'positive and statistically significant'.<sup>25</sup> The study finds that a doubling of sub-central tax or spending share – in other words moving from a decentralisation ratio of 15 to 30 per cent – is associated with an increase in GDP per capita by 3 per cent on average.

**Local government already has a role to play in all the key drivers of productivity.** Research studies tend to identify a small number of clear factors which contribute to productivity growth: human capital; the ability of firms to develop and innovate; and the environment in which workers and firms operate in terms of connectivity and infrastructure.<sup>26</sup> Local government has always had a major role in human capital and infrastructure, and some councils have sought a bigger role in encouraging innovation.

**This existing local role is being enhanced through devolution.** Unlocking regional growth is at the heart of the Government's agenda to devolve power and funding streams around skills, business support and infrastructure. The Treasury's national productivity plan identified the role of city regions within a dynamic economy to attract high value firms and skilled workers, to create markets for labour, competition between firms and to enable the diffusion of ideas.<sup>27</sup> The plan to move towards business rates localisation by 2020 means that local government's future financial sustainability will be increasingly dependent on its ability to generate and capture the proceeds of growth in the local economy.

The combination of these factors means that it is increasingly important to develop a clearer understanding of how productivity can be boosted locally. Unless local partners can drive productivity locally, growth will not be sustainable and local living standards will not improve, both of which will have increasing knock-on effects on both the resources for, and demand pressures on, public services.

---

<sup>25</sup> Blochliger, H. and B. Egert (2013), "Decentralisation and Economic Growth – Part 2: The Impact on Economic Activity, Productivity and Investment", OECD Working Papers on Fiscal Federalism, No.15, OECD Publishing.

<sup>26</sup> See for example, LSE Growth Commission (2012) *Investing for Prosperity: Skills, Infrastructure and Innovation*; and OECD (2015), *The Future of Productivity*.

<sup>27</sup> HM Treasury (2015) *Fixing the Foundations: Creating a more prosperous nation*.

# 3 TOWARDS A FRAMEWORK FOR LOCAL PRODUCTIVITY

A framework for driving local productivity needs to be based on an understanding of the different factors that account for productivity and how they interplay locally. Analysis by New Economy<sup>28</sup> of productivity in a place, measured by GVA per capita, demonstrates how productivity – and therefore output – are affected by two significant factors:

- **Demographic and participation factors:** how the supply of labour and its engagement with the local economy affect total output and productivity.
- **In-work productivity factors:** how effectively labour and other inputs are allocated and used by businesses to create outputs.

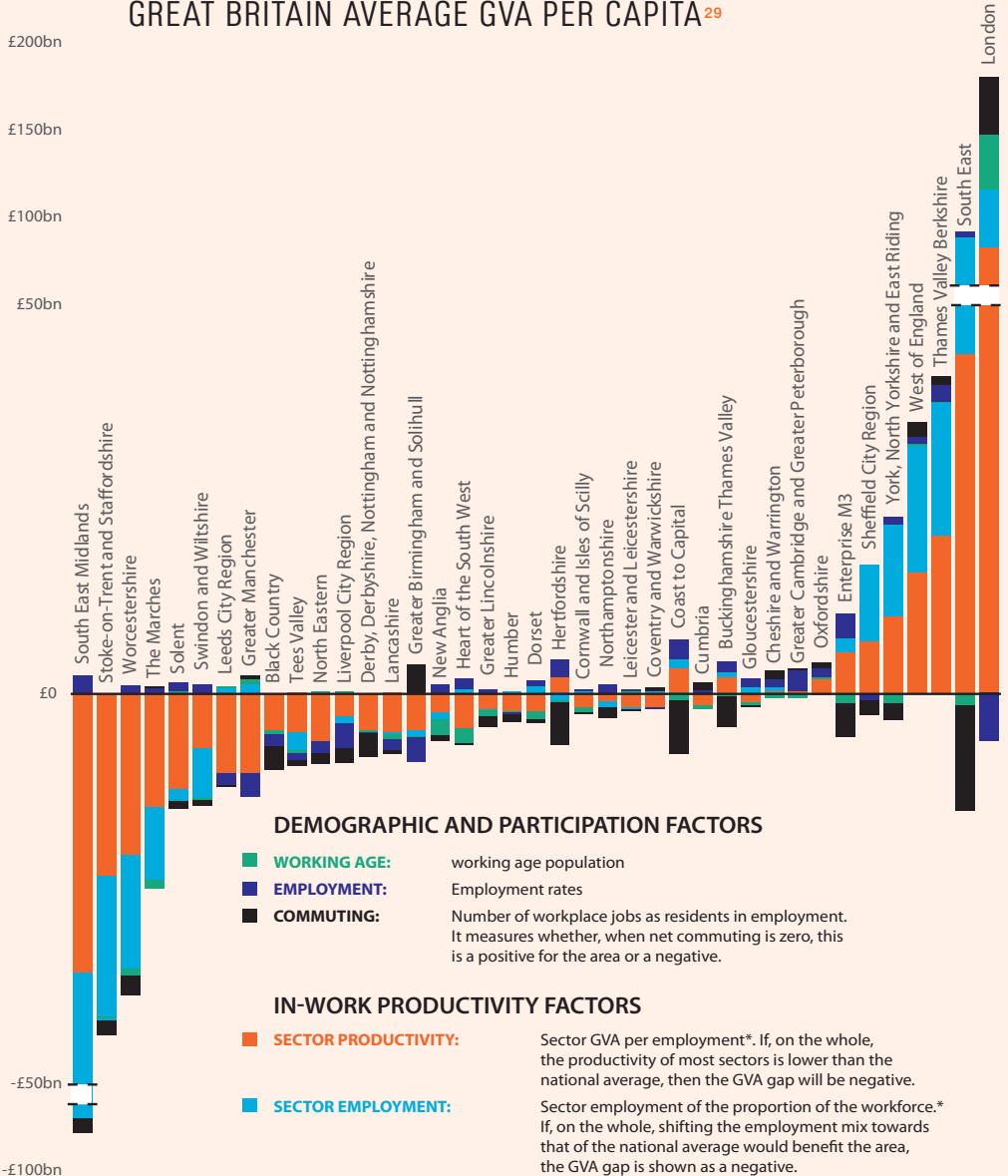
The analysis calculated the difference in GVA caused by the variation of these factors from the national average. Unsurprisingly, mapping these factors at the level of LEPs shows that there is huge variability in their impact and the factors that drive productivity across different parts of the country (see Figure 6 on pages 22-23). Each area requires its own tailored and proportionate policy response.

In some areas, the GVA gap – where GVA is lower than it theoretically could be – involves some demographic and participation factors. This points towards a need for policies geared towards attracting and retaining a skilled workforce, combined with raising the employment prospects of those not currently participating in the labour market. In areas where in-work productivity factors are predominant, and sectors are on the whole weaker than the national average, strategies to address existing workforce skills and sector productivity would help to drive greater productivity. The significance of sector productivity gaps within overall LEP-level GVA gaps suggests that a particular priority needs to be placed on raising the productivity of sectors that perform below the national average in local areas, and this should be a clear focus for local strategies to raise productivity.

---

<sup>28</sup> New Economy is the research, policy, strategy and evaluation arm of the Greater Manchester Combined Authority.

**FIGURE 6: DIFFERENCE BETWEEN LEP AND GREAT BRITAIN AVERAGE GVA PER CAPITA**<sup>29</sup>



<sup>29</sup> Analysis from New Economy using data from 2014. Sources: ONS Sub-regional GVA, Annual Population Survey and Business Register and Employment Survey. Data excludes Northern Ireland.

## EXAMPLES OF LOCAL PRODUCTIVITY GAPS IN PRACTICE

Greater Manchester's total productivity gap with the national average, as measured by GVA per capita, is £10.4 billion. That is, if the economy had the same GVA per capita as the national average, all else held equal, it could be nearly a fifth larger. Of this gap, roughly a fifth is accounted for by demographic and participation factors (net in-commuting and a higher than average working age population benefit the local economy), while a lower than average employment rate reduces the numbers of residents productively contributing to the local economy. Approximately four-fifths of Greater Manchester's productivity gap is accounted for by in-work productivity factors.

If the city region shifted its sectoral employment to match the national average, its economy would lose out – in this respect, the economy has a comparative advantage in its current sectoral distribution. However, on the whole, sectors within Greater Manchester produce significantly less per employee than the national average. This can be affected by wider issues, such as relative house and land prices as well as the focus of individual sectors and skills within sectors. Overall, this suggests that to raise its productivity, Greater Manchester should address both employment rates overall, and the productivity of key sectors.

Comparatively, Oxfordshire's productivity is above the national average by £3.8 billion. However, this topline figure hides a sector employment gap with the national average of £140 million. This indicates that to raise productivity further, it would be a priority to shift employment towards more productive sectors and support the development of businesses in more productive sectors.

This analysis provides insight into the components of an emerging local productivity framework: raising the value of total output through increasing local labour market participation; raising individual productivity in-work through enhancing skills levels; improving sector and firm-level performance; and supporting the foundations for productivity growth through enhancing connectivity.

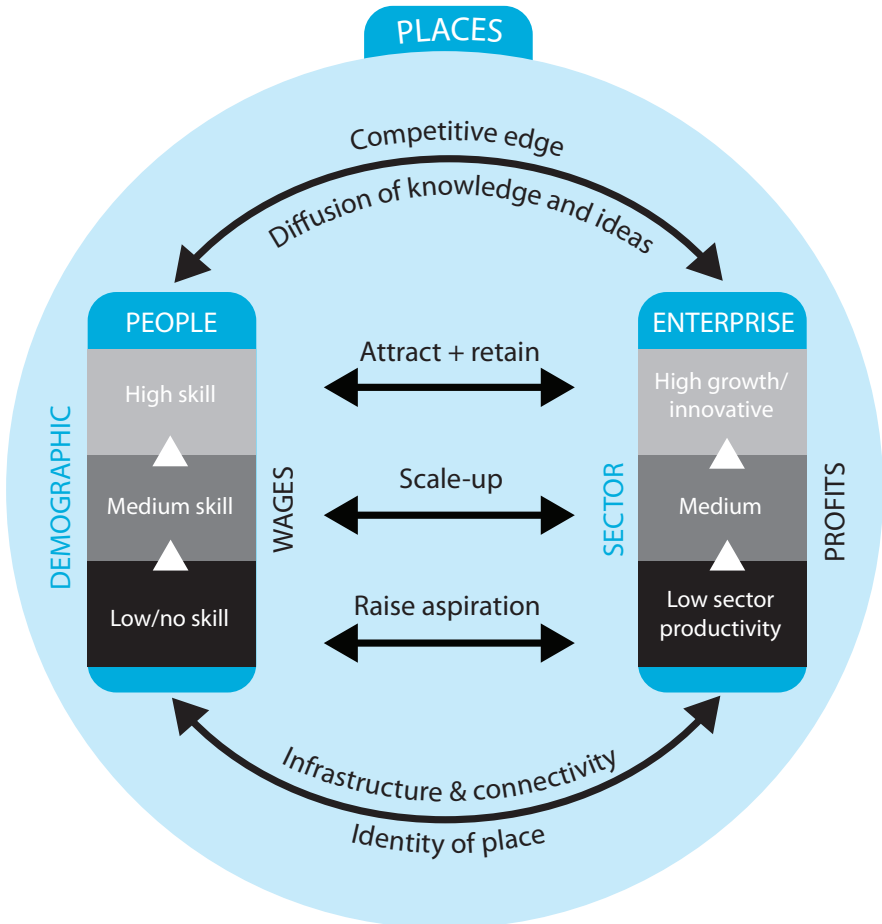
This echoes emergent themes that arise from national and international accounts of the drivers of productivity: human capital; the ability of firms to develop and innovate; and the environment in which workers and firms operate including connectivity and infrastructure.<sup>30</sup> For the purposes of this report, we have boiled the academic research down into three key areas for action: people, enterprise and places, plus the interplay between them (see Figure 7).

This framework provides a basis from which to consider how local areas can address the productivity of people, enterprise and places. Local partners including local authorities, LEPs and combined authorities where they exist, will all be addressing elements of this framework. We have used our research to develop this framework and test its application to existing local good practice. We have also identified where there are spatial blind spots in the national policy framework which hinder the ability of localities to reach their productive potential, which further devolution needs to be attuned to.

---

<sup>30</sup> See for example LSE Growth Commission (2012) *Investing for Prosperity: Skills, Infrastructure and Innovation* and OECD (2015), *The Future of Productivity*.

**FIGURE 7** A LOCAL PRODUCTIVITY FRAMEWORK: PEOPLE, ENTERPRISE AND PLACE



## A NOTE ON MEASURING PRODUCTIVITY IN A PLACE

Local strategies to address productivity need to be based on a clear understanding of the starting point. It is necessary to understand the main measurements of productivity in places and how they produce a different angle on the local productivity picture. Sub-national (including local, sub-regional and regional) Gross Value Added (GVA) refers to the increase in value of an economy due to the production of goods and services.<sup>31</sup> This measure is set against three main factors to determine productivity: per capita, per job, or per worker.

These measures each generate a different angle on the nature of productivity. For example, the per capita measure refers to the performance of all individuals in the local economy, and so indicates more about overall employment, less about high value job creation within that. On the other hand, measuring GVA per job or per hour worked considers the existing workforce only, and doesn't take account of those not participating in the labour market. These measures are more directly affected by high value job creation and sector productivity growth. Figure 8 demonstrates some pros and cons of using different measures.

Because each measure captures different aspects of the picture of productivity in a place, they can be impacted by different actions and addressing them can lead towards different policy responses. GVA per capita looks at the whole local economy, whereas GVA per job and per hour worked isolate workplace and sector challenges. Businesses focus on the latter two measures.

Local plans should be based on a 'three dimensional' understanding of each of these measures for an accurate baseline from which to assess impact. Partners may agree to focus on a specific measure above others but should have an awareness of progression across all. It is essential that all partners in a place working to address productivity understand and use the same measurements, including councils, the LEP, and other stakeholders.

---

<sup>31</sup> Office for National Statistics definition.

**FIGURE 8** PRODUCTIVITY MEASURES: PROS AND CONS<sup>32</sup>

MEASURE	PROS	CONS
<b>GVA PER CAPITA</b>	<ul style="list-style-type: none"> <li>■ Indicates economic performance of a whole economy</li> <li>■ Informs initiatives to get people into work</li> </ul>	<ul style="list-style-type: none"> <li>■ Doesn't focus on high value job creation</li> <li>■ Can be impacted by higher commuting and lower dependency</li> </ul>
<b>GVA PER JOB</b>	<ul style="list-style-type: none"> <li>■ Workplace based measure</li> <li>■ Unaffected by demographic changes</li> </ul>	<ul style="list-style-type: none"> <li>■ Doesn't take account of labour market structures or working patterns</li> </ul>
<b>GVA PER HOUR WORKED</b>	<ul style="list-style-type: none"> <li>■ Takes account of different working patterns</li> <li>■ Focuses on high value job creation</li> <li>■ Unaffected by demographic changes</li> </ul>	<ul style="list-style-type: none"> <li>■ Doesn't take account of local labour market</li> <li>■ Productivity can be enhanced through in-commuting</li> </ul>

<sup>32</sup> Based on analysis by New Economy.

## 4 PRODUCTIVE PEOPLE

Many analyses of the drivers of productivity identify human capital as an essential factor.<sup>33</sup> The skills, experience and resilience within the local labour market determines the extent to which that labour market can support high value work, implement new technologies and adopt new management approaches. It is not just the quality of human capital that is important, but also how it is allocated in the economy. Skills shortages are persistently identified by businesses as a barrier to expansion and productivity growth.<sup>34</sup> We therefore need to focus on both increasing the pipeline of skilled workers and more efficiently matching them to employer demand.

Local partners will need to establish priorities informed by an accurate understanding of local demographics and in-work productivity factors, based on data analysis of the local labour market including employment rates and wages. Businesses across sectors and employees themselves need to be actively involved in this to identify current and future skills requirements.

Based on the framework for local productivity, local strategies then need to address how policy can be tailored to boost the productivity of people across the spectrum in three core areas: supporting people to participate in the labour market; developing in-work skills; and ensuring that talented people are attracted to live and work in a place.

### SUPPORTING LABOUR MARKET PARTICIPATION

Local partners are developing a range of approaches to support and enhance labour market participation, by removing barriers to employment and playing an increasingly active role in skills provision. In many respects, local approaches compensate for problems in the national system and through devolution some new powers are creating new opportunities.

---

<sup>33</sup> See for example LSE Growth Commission (2012) *Investing for Prosperity: Skills, Infrastructure and Innovation* and OECD (2015), *The Future of Productivity*.

<sup>34</sup> CBI (2015) *Inspiring Growth: CBI/Pearson Education and Skills Survey 2015*.

Where labour market participation is a recognised productivity lag, localised approaches to employment support are designed to increase overall GVA per capita in a place. These are characterised by models based on the particular needs of identified cohorts, then designing support to address specific barriers to labour market participation such as physical or mental ill health, and integrating this with other specialist local services (see Case Study 1).

## CASE STUDY 1 GREATER MANCHESTER WORKING WELL<sup>35</sup>

Greater Manchester's Working Well pilot programme has worked with over 5,000 residents on Employment and Support Allowance to overcome their barriers to work, since 2014. The combined authority's latest devolution deal expanded this to include another 15,000 people who are out of work or in low paid work. The expanded scheme will work with a wider range of people including Job Seekers Allowance claimants, lone parents on income support and people in low paid work receiving Universal Credit. The design of the next phase incorporates lessons from the original programme, including using one-to-one skills training and mental health support, including talking therapies, as part of bespoke support packages aimed at removing identified barriers to work and progression.

Locally-developed models are increasingly designed to overcome the particular skills mismatches between provider supply and employer demand, which are specific to local economies.<sup>36</sup> Skills mismatches in local economies can have two different consequences for productivity: lack of a skilled workforce constrains the growth of innovative firms, and the over-supply of skills in other areas can depress wages.<sup>37</sup> Locally-developed models are characterised by an active brokerage function that between employers and skills providers, designed to reduce gaps between demand and supply (see Case Studies 2 and 3).

---

<sup>35</sup> Information provided by Greater Manchester Combined Authority.

<sup>36</sup> See, for example, CESI (2014) *Realising Talent: employment and skills for the future, A report for the Local Government Association*.

<sup>37</sup> OECD (2015) *The Future of Productivity*.

## CASE STUDY 2 SHEFFIELD CITY REGION SKILLS BANK<sup>38</sup>

The Skills Bank is a new service to upskill employees to drive business growth across the Sheffield City Region. It is designed to bring about a new culture in the skills system by giving employers greater purchasing power and control over how training is accessed. In doing so it seeks to change the relationship between the suppliers of the skills system – colleges and training providers – and demand for skills from businesses. It is based on a bespoke ‘economic impact’ model to assess the growth potential of skills deals and a skills assessment tool to support employers in defining their requirements. Specialist support for employers includes a dedicated helpline, a network of brokers and an online community feedback forum. The initiative is designed to align public investment to growth outcomes outlined in the LEP’s strategic economic plan: to create jobs, create businesses and increase GVA.

## CASE STUDY 3 SOUTHWARK CONSTRUCTION SKILLS CENTRE<sup>39</sup>

Southwark Council has been working in partnership with its development partner, Lendlease (Elephant & Castle) Limited, to open a Southwark Construction Skills Centre in June 2016 at the heart of its Elephant and Castle regeneration scheme. This provides construction and employability training to equip local residents with the skills and qualifications to access apprenticeships and employment opportunities within the local construction sector. Benefiting from a £0.8 million capital investment from the council and £0.4 million in sponsorship from Lendlease, the centre helps businesses meet skills shortages by delivering up-skilling training to existing construction employees and providing engagement programmes to local school-aged young people and other local residents to promote vocations within the construction and development industry.

---

<sup>38</sup> See <http://sheffieldcityregion.org.uk/skills-bank/> [accessed May 2016].

<sup>39</sup> Information provided by Southwark Council.

## IN-WORK PRODUCTIVITY FACTORS

The existing national skills and employment support system is largely focussed on job entry alone, regardless of whether or not this is low skill, low wage work. Looking to 2020, the majority of the future workforce is in work now, so local strategic economic plans to boost productivity increasingly need to focus on in-work skills progression. National policy has shifted towards greater employer involvement in skills through the apprenticeship levy and the new National Living Wage, which means firms will need to maximise productivity gains from this. So there are opportunities for local approaches to develop a stronger focus on developing in-work productivity, focussed on increasing quality of opportunity.

Local strategies should focus on raising the productivity of low value sectors. There are two aspects to this. Firstly, they need to address identified sector gaps in local economies where there are particular sectors that perform below the national average. Secondly, they should target sectors with persistently low productivity. For example, analysis has identified low productivity sectors as wholesale and retail; administration and support services; accommodation and food services; arts and recreation; and agriculture: together they comprise 33 per cent of employment share by hours worked, but only 23 per cent of GVA.<sup>40</sup> Yet these low wage sectors are less productive than advanced European equivalents: the same research estimated that the UK could eliminate a third of its productivity gap with Belgium, France, Germany and the Netherlands by raising the productivity of our low wage sectors.<sup>41</sup> For example, compared to the UK, the German retail industry has a significantly more productive workforce with stronger demand for higher level qualifications for apprenticeships.<sup>42</sup>

At city region level there is an opportunity to establish strong and direct links between skills activity and progression routes, in order to raise the

---

<sup>40</sup> Thompson, S. et al (2016) *Boosting Britain's Low-Wage Sectors: A Strategy for productivity, innovation and growth*, lppr.

<sup>41</sup> Ibid.

<sup>42</sup> House of Commons Business, Innovation and Skills and Education Committees (2015) *Education, skills and productivity: commissioned research*.

aspiration of employers to invest in productivity-enhancing measures. Research for Leeds City Region<sup>43</sup> set out how proactive employer engagement and progression-focussed initiatives can be relevant to the needs of residents and employers. This is based on international evidence which suggests that a sector-focused ‘dual customer’ approach – helping employers and low-paid workers through the same programme – can be effective. A proposed model involves three strands:

- A careers information, advice and guidance services for low-paid workers, supporting them to move between sectors with access to training.
- An dual focussed in-work advancement service focussing on employer-led training linked to career advancement, and for individuals in low-paid work focussed on training to access higher paid jobs.
- An employer-facing business support service aimed at shaping workplace practices and improving progression for part-time workers.

There is a clear role for local government coordinating different stakeholders to shape relevant programmes that tackle identified issues and barriers which vary between low wage sectors.

## ATTRACTING AND RETAINING WORKERS

Our research found that while strategic economic plans focus on skills investment, many contain a sharper approach at the lower end of the spectrum and give less attention to overcoming higher skills deficits. For localities to boost their productivity overall, they must also prioritise measures to attract and retain higher skilled people to live and work in an area.

The concept of a “sticky city” refers to how much of a magnet a place is for talent.<sup>44</sup> Evidence has shown the multiplier effect of movements in cities with lots of talent creating more jobs and attracting new businesses from

---

<sup>43</sup> Joseph Rowntree Foundation (2016) *Improving progression from low paid jobs at city-region level*.

<sup>44</sup> Hallett, T, ‘Sticky Cities: How can cities and regions attract and retain talent?’, PWC Public Sector Matters Blog. 21 September 2015.

elsewhere.<sup>45</sup> Some programmes led by local partners are geared towards retaining graduates at the start of their working lives by focussing on access to attractive starter jobs along defined career pathways (see Case Study 4).

## CASE STUDY 4 SHEFFIELD RISE<sup>46</sup>

Sheffield City Region's RISE initiative aims to increase graduate employment in small and medium sized enterprises. It is a collaboration between Sheffield Hallam University, the University of Sheffield, Sheffield City Region (in particular, the Growth Hub and local authorities) and the private sector. The programme arranges six month job placements linking graduates from the two universities with small and medium sized businesses. The programme includes ongoing support during the placement and offers business-to-business support and networking, training support and communications to firms wishing to take advantage of the opportunity to expand.

It is also important that local economies can attract experienced individuals further along in their career, who can make a difference to organisational performance.<sup>47</sup> A sustained approach to this is linked to a wider strategy to boost innovation and high end sector growth through clustering of economic activity and supporting strong social networks. Research exploring what factors make a place attractive found that people want opportunity foremost, which is linked to high intellectual capital and innovation.<sup>48</sup> The second factor identified in terms of place attractiveness was demographics and liveability, which is linked to how resources in a place support opportunity for example through planning powers. These elements will be explored further in the next two sections addressing productive enterprise and productive places respectively.

---

<sup>45</sup> Policy Exchange (2015) *On the Move*, quoted in Hallett, T (2015).

<sup>46</sup> See <http://www.welcometosheffield.co.uk/rise> [accessed May 2016].

<sup>47</sup> Hallett, T, 'Sticky cities: How can cities and regions attract and retain talent?', PWC Public Sector Matters Blog, 21 September 2015.

<sup>48</sup> PWC (2014) *We the Urban People*, quoted in Hallett, T (2015).

## PRIORITIES FOR DEVOLUTION TO SUPPORT PRODUCTIVE PEOPLE

Devolution deals are enabling a greater role for local partners to shape existing employment support and skills provision to local needs and circumstances, which should mean resources within a place can focus more sharply on boosting human capital and allocating it more effectively.

Yet the system is still fragmented and localities are held back from creating coherent pathways into labour market participation and vocational skills pipelines. Devolution to date has been characterised by passing down the riskier ends of the system: the failing Work Programme and reduced 19 plus adult skills budgets feature prominently but other parts of the system, notably 16-18 further education feature weaker commitments. Some policy areas are completely removed from devolution such as under 16 education and apprenticeship funding. There are concerns that the apprenticeship levy as currently envisaged will incentivise quantity of placements over quality and relevance that businesses need.<sup>49</sup>

**The next stage of productive devolution should devolve single local accountability over the entire employment and skills system.** This would enable a more coherent whole system approach to getting people into work and progressing within work, reflecting local economies and minimising the disruption of transitioning between services. Strong local frameworks need the levers to effectively develop human capital and ensure the right skills are being produced for the local labour market. To enable this, the budgets and functions related to skills and employment support services should be devolved to localities, including 16-18 further education budgets, the apprenticeship levy and local Jobcentre Plus employment advice services.

---

<sup>49</sup> Fairbairn, C, 'A radical rethink for Apprenticeship Levy', CBI Business Voice, 29 April 2016.

**Devolving full accountability over the skills and employment system would focus resources currently fragmented nationally<sup>50</sup> on more impactful local strategies based on identified demographic and labour market challenges.** New local accountability can be developed that reflects the range of local stakeholders involved including employers, schools, learning providers and higher education institutions so that high quality provision can be designed to meet individual and labour market needs.

**This will mean that services can be designed to develop human capital and more effectively match workers with jobs to drive sector productivity.**

For skills provision, this would mean that skills pipelines can be more effectively developed, with curricula based on business intelligence focussed on delivering high quality placements and training responsive to local labour market needs (see Case Study 5 for the German model of vocational education). Provision across age ranges could be designed to be better tailored to in-work progression focussed activities where sector productivity gaps suggest this is a priority. For employment support, this can be better linked into skills provision, geared towards designing pathways into sustainable employment based on identified demographic groups and with a focus on increasing labour market participation overall. This would involve closer integration with other services such as health and mental health support to ensure a more sustained approach to removing barriers to work.

## CASE STUDY 5: VOCATIONAL EDUCATION AND TRAINING (VET) IN GERMANY<sup>51</sup>

The majority of Germany's workforce receives its high qualification through the dual VET system, which integrates work-based and school-based learning. German companies play a strong role turning apprentices into customised specialists at net low costs through in-

---

<sup>50</sup> CESI (2014) *Realising Talent: employment and skills for the future, A report for the Local Government Association.*

<sup>51</sup> OECD (2010) *Vocational Education and Training in Germany: Strengths, Challenges and Recommendations*; Germany Trade and Invest (2014) "Vocational Training "Made in Germany": Germany's Dual System of Vocational Education and Training (VET)"; and European Quality Assurance in VET: <http://www.eqavet.eu/gns/what-we-do/implementing-the-framework/germany.aspx> [accessed June 2016].

house training. Held in high esteem in German society, the system offers qualifications in a broad spectrum of professions and flexibly adapts to the changing needs of the labour market.

Partnership is a key underlying principle which makes the system so successful. Representatives of the federal state, the individual states, employers and employees work together by consensus to develop curricula, provide training, and certify and quality assure the assessment process.

Accountability over the system is highly devolved. Responsibility for school education rests with the 16 Länder and responsibility for the majority of vocational schools rests with the Land and a local authority. Each Land has a committee for vocational training, with equal representation of employers, employees and the highest Land authorities, and they advise on vocational training issues in schools.

# 5 PRODUCTIVE ENTERPRISE

Ultimately, the only thing that can drive up productivity is the private sector itself. Local enterprise – from entrepreneurs and small businesses, through to larger companies and innovative spin outs – is an essential part of the picture. Evidence suggests that competition is good for productivity growth, since this catalyses firms to innovate and be more productive to stay ahead.<sup>52</sup> An environment which reduces barriers to firm entry and exit can be conducive to this.<sup>53</sup> Supporting companies to expand into new national and international markets can raise productivity through transfer of knowledge between firms and customer bases, as well as increased market share and profits.<sup>54</sup>

Taking a scattergun approach to attracting and growing businesses is unlikely to yield long term productivity benefits. Neither is it a good idea to focus on trendy new sectors. Instead, cities and shires need to understand what makes them and their business base special. Evidence from successful local economic development strategies internationally demonstrates that they tend to be based on specialisation in a small number of sectors, with policy integrated to support this focus (see, for example, Case Study 6 looking at Eindhoven’s innovation strategy).<sup>55</sup>

This section will consider how strategies can be applied to support enterprises at different stages of growth, and then how the national policy framework can be adapted to support the integration of policy to support local innovation ecosystems to thrive.

---

<sup>52</sup> European Investment Bank (2011) *Productivity and Growth in Europe*, EIB Papers, Volume 16 No1 – 2011.

<sup>53</sup> OECD (2015) *The Future of Productivity*.

<sup>54</sup> Thompson, S. et al (2016) *Boosting Britain’s Low-Wage Sectors: A Strategy for productivity, innovation and growth*, Ippr.

<sup>55</sup> Ernst and Young (2015) *Rebalancing: UK region and city economic forecast*.

## CASE STUDY 6 EINDHOVEN'S PLACE-BASED INNOVATION STRATEGY<sup>56</sup>

Eindhoven (SRE) is a voluntary alliance of 21 municipalities in the Eindhoven agglomeration, in the Netherlands. The country itself is a decentralised unitary state organised at central, provincial and municipal levels, with a formalised system of horizontal cooperation between municipalities sharing the same urban system. Eindhoven faced decline in the 1980s and 1990s when electronics giant Philips relocated its head-quarters and off-shored its manufacturing. The SRE initiated a series of knowledge improvement strategies targeting the high-tech sector, including Stimulus in 1994 and the triple-helix based Horizon Programme in 2002.

This success formed the basis of Brainport Eindhoven, a programme developed in 2004 by a local taskforce comprised of the mayor of Eindhoven and chair of the SRE, the chairman of Philips, the president of the Eindhoven University of Technology, and the chairman of the regional Chamber of Commerce. The goal of the project was to strengthen the region's high tech and manufacturing industries through collaboration to identify and resolve shared challenges.

The programme has been successful in promoting open innovation throughout the region: it is currently one of the top three regions for patent density in Europe, accounting for 55 per cent of all Dutch patents and 36 per cent of all Dutch private R&D expenditure. Brainport is one of the fastest-growing regions in the Netherlands: industrial exports rose by five per cent in the year to 2015 and the same year Brainport companies derived 43 per cent of their revenue from the sale of new products, demonstrating successful innovation. In 2011 it was declared "the smartest region in the world" by the Intelligent Community Forum, an international think tank focusing on the economic and social impact of the broadband economy.

---

<sup>56</sup> OECD (2010) *Better Regulations in Europe: The Netherlands*; OECD (2007) *OECD Reviews of Regional Innovation Globalisation and Regional Economies Can OECD Regions Compete in Global Industries?*; Bradley, J. and Katz, B. "What America's Metropolitan Revolution Can Teach Europe", 31 October 2013; and <http://www.brainport.nl/en/> [accessed June 2016].

## SUPPORTING BUSINESSES TO ACCELERATE ACROSS THE SPECTRUM

Local authorities have long provided a range of business support, and by partnering with LEPs over growth hubs there have been recent moves to join up local and national support into a clearer local business offer. Yet this has been relatively small scale in terms of time and funding, and although business support funding streams have been devolved, they have also been reduced.<sup>57</sup> Business support tends to be focussed on jobs growth and expansion generally, rather than productive growth specifically. Local government, working their business community through the LEP and beyond, have an opportunity to change this, targeting their support at the kinds of business with the greatest potential to improve output. Then, either directly or through the use of networks, create opportunities for businesses to access the expertise and advice needed to scale up.

Local productivity strategies need to be based on an analysis of economic strengths and weaknesses, and identify where sector productivity is weak compared to the national average, or where low productivity sectors form a significant part of the labour market. Identifying specialisms will be important to guide a strategic approach to driving productivity (see Case Study 7). In each LEP, sectors may seek equal recognition and a broad focus since they each promote themselves separately, so defined specialisms between and within specific sectors will be important to focus energy and resource and develop competitive advantage.

### CASE STUDY 7 THE NORTH EAST STRATEGIC ECONOMIC PLAN<sup>58</sup>

The North East SEP was produced following an economic review of the region. It sought to develop a comprehensive and imaginative approach to developing innovation, based on smart specialisation principles and an Open Innovation approach. A North East

---

<sup>57</sup> HM Treasury (2015) *Spending Review and Autumn Statement*.

<sup>58</sup> North East LEP (2014) *More and Better Jobs: A Strategic Economic Plan for the North East*.

Innovation Leadership Board and Executive provides the capacity for coordination, and engages an international innovation advisory group to oversee projects. Investment is focussed on key innovation hubs and projects in specialisms including process innovation, healthcare photonics, formulated products and processes and low carbon energy. The SEP also prioritises developing the internationalisation of the regional economy including an active approach to attracting foreign direct investment and supporting businesses to export.

There are particular opportunities for local strategies to support small businesses to be effective, since they rely on local intelligence and networks. Nationally-led sector-driven approaches are more likely to work for large companies who have greater capacity to take advantage of them. Research from the US has highlighted how traditional local economic development prioritised attracting big business, so-called 'elephant-hunting'.<sup>59</sup> It finds that overreliance on this strategy might overstate the importance of large firms and for local areas over-dependence on too few 'elephants' creates vulnerabilities. The research concluded that it might be more effective for a region to grow its small businesses than enter into a bidding war with another locality – a process that too often helps only the elephant.

Small businesses are the predominant users of local business support. Research has shown that provision needs to be designed in the context of local economic conditions and opportunities, and targeted and based on sustained engagement to ensure those who participate are most likely to benefit.<sup>60</sup> Business support also needs to be designed based on evidence of what works to improve outcomes. To boost productivity specifically (as opposed to other growth measures such as employment), the use of mentors have been found to be more effective than public advisory services.<sup>61</sup> It is important to put rigorous evaluation mechanisms in place, based on an established baseline and an assessment over time to ensure interventions are working and represent value for money.<sup>62</sup>

---

<sup>59</sup> Mills, K, 'A Playbook for Making America More Entrepreneurial', Harvard Business Review, 27 May 2015.

<sup>60</sup> See Federation of Small Businesses (2015) *A New Design: Making local support work for business*.

<sup>61</sup> See What Works Centre for Local Economic Growth Business Advice toolkit <http://www.whatworksgrowth.org/resources/business-advice-toolkit/> [accessed June 2016].

<sup>62</sup> Federation of Small Businesses (2015) *A New Design: Making local support work for business*.

Across the spectrum of growth potential, local strategies to drive productivity need to be geared towards developing business' appetite to scale-up, based on identifying and removing barriers. Creating the conditions for productive growth will necessarily mean different emphases in different places. In Suffolk there is a priority on ensuring land allocation is relevant for future business growth site needs, and removing barriers to smooth the transition for businesses relocating and expanding. In Sheffield, supporting businesses to export is highlighted – their approach involves segmenting the export-readiness of local firms into groups according to how far they are along the spectrum, then providing a range of appropriate interventions including developing skills, opening doors and helping firms access the right people or trade missions.

Businesses also need to be encouraged to invest in new products and processes such as new technology and more effective management techniques, which contribute to productivity gains. To this end, developing strong networks of collaboration and exposure to peer experience will be important. Evidence from successful programmes to foster entrepreneurialism in the US suggests they need to involve partnerships between many players: businesses, local governments, research universities and colleges, as well as entrepreneurs themselves.<sup>63</sup> In the US, institutions for collaboration are emerging to play an active intermediary role, such as Northeast Ohio's Regional Competitiveness Council (see Case Study 8). Similar models could be led in the UK across new combined authority geographies, focused on creating such "horizontal" place-based collaborations that develop core strategic objectives and foster business support opportunities within that. Delivery would then be focussed across the spectrum of small to medium to large companies' needs to remove barriers to firms' accelerating innovation (see Case Study 9).

---

<sup>63</sup> Mills, K, 'A Playbook for Making America More Entrepreneurial', Harvard Business Review, 27 May 2015.

## CASE STUDY 8 NORTHEAST OHIO'S REGIONAL COMPETITIVENESS COUNCIL<sup>64</sup>

Northeast Ohio's Regional Competitiveness Council was established in 2013 on the initiative of corporate, chamber of commerce and philanthropic foundation leadership. Its purpose is to set goals and identify actions to strengthen the sub-regional economy. They came together to create a more strategic approach to economic competitiveness efforts, across the 18 counties of Northeast Ohio, based on an understanding that previously efforts and investment were spread across too many industry sectors.

Their "Go-Big" strategy focusses on a few core objectives including:

- To make larger commitments to fewer industry clusters in advanced energy, flexible electronics and water technologies.
- To increase the emphasis on business retention and expansion through a growth-oriented approach to matching the most promising local companies to innovation assets in the region's universities, intermediaries and industry sectors; and building more robust regional value chains.

The strategy is delivered by Team NEO and operates as a collaboration of the region's chambers, foundations, businesses and employment service. Team NEO's cluster acceleration team brings together industry expertise to accelerate the pace of innovation, including by providing SMEs with opportunities and resources to shorten the time it takes to commercialise products or services, and large anchor companies to connect them to the regions innovative technologies.

## CASE STUDY 9 VERMONT'S FARM TO PLATE STRATEGY<sup>65</sup>

As a strategic approach to developing Vermont's food system, Farm to Plate is a network of over 350 businesses, non-profit organisations,

<sup>64</sup> See <http://www.rccstrategy.org/> and <http://www.teamneo.org/> [accessed May 2016].

<sup>65</sup> See <http://www.vtfarmlandplate.com/plan/> [accessed May 2016].

government agencies, capital providers and educational institutions. They collaborate and align their activities in support of a 25 point plan to strengthen the state's food system which is fundamental to the economy. Over five years, the initiative has seen sustained growth in food system sales, jobs, businesses and increases in value-added manufacturing, financing opportunities and supply chain connections.

## FOSTERING LOCAL INNOVATION ECOSYSTEMS

Innovation is a key driver of productivity performance – it can help to create a sustainable high performing economy, creating new businesses, markets and high value jobs.<sup>66</sup> Many national-level analyses of the UK's productivity gap cite low levels of investment in innovation, particularly R&D, compared to other countries as a causal factor.<sup>67</sup> Despite a substantial body of research supporting the benefits of high value companies clustering together,<sup>68</sup> and recent support for the idea of 'innovation districts' to drive high value growth,<sup>69</sup> support for innovation in the UK has traditionally been led nationally. For example, the Catapult centres, designed to improve linkages between academia and businesses to boost profitability of scientific innovation in key areas, implemented directly by Innovate UK, a body of the Department of Business, Innovation and Skills (BIS). National innovation agencies such as Nesta tend to focus on supporting initiatives on a one-off basis across the country, rather than focusing on creating the conditions for systemic innovation in towns and cities.

Research into high growth firms, in other words those which experience above average growth over three years, identifies the role of innovation as important and suggests two main routes to supporting that innovation to occur.<sup>70</sup> Firstly, high growth firms benefit from proximity to other firms, as clustering of economic activity can attract investors, spread knowledge

---

<sup>66</sup> Written evidence from Innovate UK, listed in House of Commons BIS Select Committee (2016) *The Government's Productivity Plan*.

<sup>67</sup> Jones, R. (2016) *Innovation, Research and the UK's productivity crisis*, Speri Paper No. 28; and LSE Growth Commission (2012) *Investing for Prosperity: Skills, Infrastructure and Innovation*.

<sup>68</sup> Mills, K, 'A Playbook for Making America More Entrepreneurial', Harvard Business Review, 27 May 2015.

<sup>69</sup> Katz, B. and Bradley, J. *The Metropolitan Revolution*, Brookings Institution Press (2013)

<sup>70</sup> Sena, V et al, (2013) *Innovation and UK High-Growth Firms*, Nesta Working paper No. 13/12.

and be supported by R&D investment. Secondly, high growth firms need access to investment that can help them grow fast such as access to training, software or business processes to take advantage of commercial opportunities.

As devolved arrangements take shape, they will create new opportunities for local authorities to support innovation in these ways. For instance, councils can help to foster connections between business and universities, a relationship which is associated with better growth outcomes.<sup>71</sup> Local government is already taking a lead in this area, for instance through the Leading Places Project pilots in which vice chancellors and council chief executives agree shared priorities for creating opportunities, innovation and skills.<sup>72</sup>

Higher education institutions are increasingly prioritising their role as civic institutions and engaging with devolution as they seek wider impact. They should be actively involved in developing local economic strategies, to ensure their expertise and assets support local innovation ecosystems for productivity, including through identifying specialisms and creating conditions for knowledge spillovers. Higher education institutions should be encouraged to forge wider links with further education provision locally, support wider networks and expertise-sharing. The UK higher education sector's international reputation can serve to attract inward investment which can also support the development of specialised clusters.<sup>73</sup>

The public sector can potentially play a significant role in helping high value businesses access investment. There is evidence of significant regional variation in SMEs' ability to access capital outside London and the South East, which undermine the ability of high growth firms to invest.<sup>74</sup> This suggests that entrepreneurial businesses are being held back because they

---

<sup>71</sup> DTI/ONS 2001, Lambert 2003, quoted in Colledge, B. and Conkar, T. (2015) 'Joining the Dots: Universities' roles in integrating local, regional, national and international geographies', in *Until we have built Jerusalem: The role of Universities in the changing Northern Political and Spatial Geography*, Leeds Beckett University (2015).

<sup>72</sup> 'Universities and councils to collaborate in local growth pilots', Emma Rumney in Public Finance, 13 May 2016.

<sup>73</sup> Colledge, B. and Conkar, T. (2015) 'Joining the Dots: Universities' roles in integrating local, regional, national and international geographies', in *Until we have built Jerusalem: The role of Universities in the changing Northern Political and Spatial Geography*, Leeds Beckett University (2015).

<sup>74</sup> House of Commons BIS Select Committee (2016) *The Government's Productivity Plan*.

operate in parts of the economy where traditional financial intermediaries struggle to price risk effectively and investors struggle to understand the development of new business models and intangible assets. So growth funding needs to be matched to firms with high growth and productivity potential more effectively where there is market failure.

There is potential for stronger horizontal institutional collaboration between higher education, LEPs and combined authorities to create new joint investment funds to support high growth spinouts and create access to capital for high growth potential firms. These would be based on sector specialisms supported by academic excellence and growth fund resources from the LEP. Local authority bonds could provide a basic anchor and then offer differential levels of risk. This has the potential to then crowd in further private sector funds, including leveraging venture capital investment.

The New Anglia Capital joint venture provides a possible model for this (see Case Study 10). To extend the model more broadly, local authorities will have to develop the expertise and appetite to take on greater levels of risk. This is a challenge for democratically-accountable public institutions, but it is likely an area local government increasingly must venture into as the sector becomes more financially independent.

## CASE STUDY 10 NEW ANGLIA CAPITAL<sup>75</sup>

New Anglia Capital is a new co-investment fund aimed at stimulating entrepreneurship across Norfolk and Suffolk. It launched with £1 million of funding from New Anglia LEP. It brings businesses and “angel investors” together to kick-start new products and innovative ideas into start-up businesses, as well as support existing high-growth companies. Angel investors invest 50 per cent of the risk capital in the successful businesses, with New Anglia Capital providing the remaining 50 per cent. The aim is to encourage economic development by job creation in early-stage businesses with high potential in key sectors where there is strength in the region: engineering, life sciences, agri-tech, health, energy, communications and digital.

---

<sup>75</sup> See <http://www.newanglia.co.uk/new-anglia-capital/> [accessed May 2016].

## PRIORITIES FOR DEVOLUTION TO SUPPORT PRODUCTIVE ENTERPRISE

As local collaboration develops, the national framework for fostering innovation will need to become more spatially sensitive and develop bilateral plans with places. During our research, several interviewees highlighted the blanket national approach taken by BIS and related bodies such as UK Trade and Investment, Innovate UK and the Higher Education Funding Council for England (HEFCE). They do not coordinate with each other and have set calls at set points that do not align, which leads to fragmentation locally. This can undermine a focus on place-based sector and innovation specialisms and local efforts to maximise gains from investment that does occur.

So in order for the national framework to better support local strategies to drive business productivity and innovation, we recommend:

**Innovation strategy should shift from a national sectoral model with little geographical focus, to a place-based approach.** The Science and Innovation Audits being carried out through BIS which are mapping regional strengths should inform this shift. The evidence base needs to inform more direct working with places to identify local sector strengths, support cluster development and raise the potential for investment in the underlying capabilities of places. The regional cluster strategy in Norway (see Case Study 11) demonstrates how a national approach can be more locally adaptable to work with regional strengths to raise potential at different stages of development.

**National innovation strategy then needs to support the horizontal collaboration developing in places across combined and local authorities, LEPs, higher education institutions and other relevant stakeholders.** Existing investment to support innovation coming through different national bodies such as Innovate UK, HEFCE and BIS through funding streams or opportunities should then be mapped, coordinated and eventually aligned into single city or county region innovation funds. This would mean that currently disparate, fragmented resource can be more effectively used to impact innovation.

**A stronger place-based approach would then mean that wider local plans can maximise the impact of investment to help catalyse innovation and leverage in private investment.** Where the Catapult network is currently focussing on developing links between businesses, engineers and scientists to drive the commercialisation of technology, this approach needs to become much more integrated into local planning. Wider infrastructure and business support decisions need to be taken in the context of place-based innovation programmes to maximise local benefit - for example through supply chain initiatives geared towards enhancing the potential for innovation amongst SMEs.

**UKTI should work closely with city and county regions to develop bespoke plans for boosting the exports of innovative goods and services and build sub-regional international links.** This would be based on joint accountability over local trade and investment strategies between UKTI and combined authorities. HMRC should make LEP-level export data available, so local strategic economic plans can be based on identified strengths and weaknesses and better assess impact. Then joint design and commissioning of UKTI programmes would enable more bespoke packages of support to be devised which supports building international links between sub-regions and identified international markets, opening doors, tapping into networks and advice on breaking into new markets.

## **CASE STUDY 11 A PLACE-BASED NATIONAL STRATEGY FOR CLUSTER IMPACT IN NORWAY<sup>76</sup>**

A collaboration between Innovation Norway, SIVA (Norway's Industrial Development Corporation) and the Research Council of Norway, the Norwegian cluster support strategy consists of three sub-programmes and serves as a good example of a differentiated approach to cluster development:

- For regional clusters in different stages of development from early to mature, the focus is on boosting innovation activities

---

<sup>76</sup> European Commission (2016) *Smart Guide to Cluster Policy*, European Commission Guidebook Series.

and improving capacity for renewal through strengthening collaboration between companies, knowledge communities and public development agencies.

- For clusters whose primary potential lies in a strengthened regional position, the focus is on creating Norwegian Centres of Expertise through increased value creation.

For clusters that have enough weight and capacity for growth to act as hubs for national and global innovation networks, the focus is on creating Global Centres of Expertise with increased value creation and attractiveness and a better position in global value chains.

# 6 PRODUCTIVE PLACES

The third element of the local productivity framework is place. Productive places are those that connect workers to jobs through decent housing and good transport links, connect businesses to the world through strong physical and digital connectivity, and which attract investment by providing a decent environment and cultural offer.<sup>77</sup> This is arguably the area where councils can do the most to promote growth, because many of the necessary powers are already being devolved. The question is how to use those powers most effectively.

## STRATEGIC FOCUS ON INFRASTRUCTURE AND CONNECTIVITY

Economists have varying views on the role of different environments for fostering productive growth. Some have argued that the clustering of similar industries and sector specialisms in industrial parks is the best way to stimulate innovation and job growth.<sup>78</sup> More recently, increasing focus has been on the role of the city, with the density and diversity of economic actors whereby that “collision” between people with ideas, skills and investment ability catalyses innovation.<sup>79</sup>

Both views highlight the importance of clustering of economic activity and creating business density, which can produce agglomeration benefits. These can drive productivity gains because proximity and density more effectively matches skilled workers to jobs; facilitates knowledge exchange between individuals and companies; and enables businesses to share inputs such as supply chains and infrastructure.<sup>80</sup>

---

<sup>77</sup> OECD (2015) *The Future of Productivity*.

<sup>78</sup> Porter, M (1990) *The Competitive Advantage of Nations*, quoted in Cohen, B. ‘What makes a thriving and interesting city? Something called collision density’ Fast Co.Exist blog, 11 May 2016.

<sup>79</sup> Jacobs, J. (1961) *The Death and Life of Great American Cities*, quoted in Cohen, B. ‘What makes a thriving and interesting city? Something called collision density’ Fast Co.Exist blog, 11 May 2016.

<sup>80</sup> Swinney, P. (2016) *Building the Northern Powerhouse: Lessons from the Rhine-Ruhr and Randstad*, Centre for Cities.

Different places will experience different barriers to productive growth. For example, in and around London, increasingly high land prices constrain productivity, making the costs of business expansion and housing the workforce steep. In other parts of the country, sustained lack of investment in transport infrastructure has created poor physical connectivity,<sup>81</sup> which undermines access to markets, puts off inward investment and creates commuter lags. In many rural areas, poor broadband coverage means that digital connectivity is a priority alongside physical (see Case Study 12).

## CASE STUDY 12 PRODUCTIVITY IMPACT OF SUPERFAST BROADBAND IN CORNWALL<sup>82</sup>

Superfast Cornwall was a next generation broadband (NGB) infrastructure project funded through European Regional Development Fund and BT, which rolled out fast, fibre-based broadband to a target 95 per cent of homes and businesses in the county. An evaluation of the scheme found that as well as increasing jobs and turnover growth, a survey of 22 businesses showed that productivity had increased by 30 per cent since they upgraded. Stakeholder surveys also identified the role of superfast in helping encourage some businesses to relocate to Cornwall.

New mayors working with combined authorities will need to develop an integrated approach to driving productivity that addresses the key blockages across their area. The Norfolk and Suffolk Productivity Commission established as part of the devolution deal area (see Case Study 13) provides a model for how localities can assess and define priorities for emerging strategic economic governance.

---

<sup>81</sup> See Cox, E. and Raikes, L. (2015) *Transport for the North: A blueprint for devolving and integrating transport powers in England*, Ippr North.

<sup>82</sup> Serio, A Plymouth University Centre of Expertise and Buckman Associates Ltd (2015) *Superfast Cornwall Evaluation*.

## CASE STUDY 13 NORFOLK AND SUFFOLK PRODUCTIVITY COMMISSION<sup>83</sup>

The New Anglia LEP is setting up a Norfolk and Suffolk Productivity Commission, as part of its devolution deal, to act as a national pilot to improve the productivity of the local economy. It is being established based on an identified need to develop a clearer understanding of the impact of investment and to underpin this with a clear analysis of priorities. The Commission will be chaired by a senior business figure and funded by local partners. It will examine the productivity challenges facing local key sectors; identify best practice locally, nationally and globally at tackling those challenges; and assess the impact of existing central and local policies. This analysis will feed into the development of a Productivity Plan for the area, and the Commission will then oversee its implementation and evaluate its impact. The initiative is intended to produce findings and actions that can be used in other localities.

Where new clustering of economic activity is planned, an active housing pipeline to support inward migration of workers needs to be in place, so that suitable and affordable housing options enable workers to relocate to support expansion. Not aligning housebuilding plans in this way over the medium to long term could result in increased pressure on existing stock and house price growth. This in turn could have repercussions for reduced labour market flexibility because it is harder for workers to access employment – this could have consequences for productivity further down the line.<sup>84</sup>

The benefit of devolving decisions over transport investment to combined authority areas is so that plans can be based on an identification of local pinch points. Research comparing productivity across the North of England with more productive regional counterparts in the Netherlands and Germany has warned against the lure of the ‘grand projet’ focussed on connections between cities, and instead emphasised the need to focus on connectivity

---

<sup>83</sup> Information provided by New Anglia LEP and Suffolk County Council.

<sup>84</sup> PWC and Demos (2015) *Good Growth for Cities 2015*.

within city regions to maximise productivity gains.<sup>85</sup> Congestion is a significant drag on productivity: on current trends by 2030 the UK will lose more per year than the entire transport budget for 2014.<sup>86</sup>

Transport infrastructure planning, using new devolved powers, should now become an integral part of wider productive growth plans. They need to be based on an assessment of how investment decisions can unblock the specific productivity gaps that exist, which may be about businesses' access to markets, or linking residential to employment sites to speed up commuting journey times. Priorities should be based on evidence of what works, and an understanding of how scheme prioritisation can unblock barriers to productive growth. For example, a study of the effects of road project investment on firms indicated that it can lead to area-level increases in employment and number of plants, but that some sectors gain more than others – notably producer services and land transport, with insignificant effects for manufacturing and consumer services.<sup>87</sup>

## STRATEGIC FOCUS ON CULTURE AND IDENTITY

Alongside this focus on infrastructure and connectivity, place-shaping for productivity also needs a sustained focus on developing aspects of culture and identity. This is linked to the niche assets and industrial specialisms that contribute to comparative advantage, but also reflects the unique character of a place that relates to its sense of opportunity, drive and potential. This all combines to create a sense of “stickiness” within a place – a concept that relates to liveability and the wider provision of goods and services, which all contribute to how attractive a place is for both workers to settle in and businesses to invest in.<sup>88</sup>

---

<sup>85</sup> Swinney, P. (2016) *Building the Northern Powerhouse: Lessons from the Rhine-Ruhr and Randstad*, Centre for Cities.

<sup>86</sup> Core Cities (2016) *Core Cities Delivering Place-based Productivity, Key Challenges and Priorities for Budget Statement 2016*.

<sup>87</sup> Gibbons, S et al (2012) *New road infrastructure: the effects on firms*. SERC Discussion Papers SERCDP117. Spatial Economics Research Centre (SERC), LSE.

<sup>88</sup> Hallett, T, 'Sticky cities: How can cities and regions attract and retain talent?', PWC Public Sector Matters Blog. 21 September 2015.

Recent research identified the role of brand and identity as important in determining the lens through which a place is viewed externally, and established three core questions which local stakeholders should focus on in developing this:<sup>89</sup>

1. What is/can our place be famous for?
2. How do we extend/refresh our brand building on existing assets?
3. How can we attract, and retain, the talent and finance to sustain future growth?

This process should feed into a clear sense between local stakeholders of what the shared vision of a place is. Across a place, arts and cultural institutions should be mobilised to contribute to this and work as networks that share ideas to develop this, and maximise the use of these existing assets. Local strategies should consider how platforms for civic entrepreneurialism can be better supported and connected, for example through workplace hubs and meetups. A vibrant civic sector can contribute to building an active sense of place and future potential.

A strong sense of place identity, developed internally and promoted externally, can contribute to excite national and overseas interest and investment in realising a shared vision of the future.<sup>90</sup> Recent moves towards shaping the Northern Powerhouse and the Midlands Engine, among others, although initiated by Government, reflect this identified need to develop a clearer brand identity across regions.<sup>91</sup> The role of directly-elected mayors will give a new voice to the political articulation of that vision and ambition of a place, led by areas more directly.

---

<sup>89</sup> PWC and Demos (2015) *Good Growth for Cities 2015*.

<sup>90</sup> PWC and Demos (2015) *Good Growth for Cities 2015*.

<sup>91</sup> For example, see BIS and CLG (2015) *The Midlands Engine for Growth: Prospectus*.

## PRIORITIES FOR DEVOLUTION TO SUPPORT PRODUCTIVE PLACES

The Government has used devolution deals to devolve new growth-related levers to places, but the approach has not been driven by the need to drive productivity specifically. The next steps for productive devolution are:

**Government should recognise that growth is at the core of what local government does everywhere, and is not a discretionary add-on.** The national framework needs to move from being a system characterised by competitive bidding for pots of funding to one which recognises local government's core role in driving growth through the range of decisions it takes over places and the allocation of resources in a place. All areas should be able to assume greater powers over road investment, bus routes and investment in broadband coverage so that where connectivity challenges exist, they can be directly addressed without waiting for national bodies to prioritise them.

**Future devolution should be informed directly by the need to drive productivity and unblock locally identified barriers to productive growth.** This would involve a more bespoke approach to future deals that devolve powers which enable productive growth strategies to meet their potential. For example, where housing affordability is a recognised challenge, more locally flexible regulation, removal of the HRA borrowing cap and devolved housing investment budgets should be enabled.

**The Government should embed long term certainty through devolution,** recognised as a key pillar in the Government's Productivity Plan.<sup>92</sup> To support this priority, the Government should move towards five year capital budget allocations for infrastructure which would create longer term certainty over investment by enabling local partners to better plan to support future productivity plans and align decisions over skills and sector growth strategies. This would also remove existing perverse incentives on LEPs to have to spend allocations in-year which can create inefficiency and project trade-offs.

---

<sup>92</sup> HM Treasury (2015) *Fixing the Foundations: Creating a more prosperous nation*.

# 7 LOCAL GOVERNANCE: FROM STRUCTURES TO INCENTIVES

The process of devolving power from Whitehall to city and county regions, although geared towards stimulating growth, has been dominated by discussions about structures. First, LEPs were designed to create a link between local decision-making and business concerns. Then combined authorities and directly-elected mayors were preconditions for significant devolution deals in most areas, on the basis that this would simplify accountability.

The next wave of devolution to mayors and combined authorities must be squarely aimed at solving the productivity puzzle in city and county regions. This requires the government to move beyond its current focus on structures. Instead, we need to understand how the emerging fiscal framework for local government can be altered to provide stronger incentives for productivity growth. The OECD has demonstrated the existence of a statistical relationship between devolving tax raising powers and improving GDP per capita, productivity and human capital.<sup>93</sup> Now is the right time to consider how greater financial decentralisation might help the UK to catch up with its international competitors.

## REFORM OF EXISTING LOCAL REVENUE: BUSINESS RATES RETENTION

It is well established that the UK has one of the most centralised systems of public finance of major OECD countries.<sup>94</sup> In England, it is estimated that even after the implementation of 50 per cent business rates retention

---

<sup>93</sup> Blochliger, H. and B. Egert (2013), *Decentralisation and Economic Growth – Part 2: The Impact on Economic Activity, Productivity and Investment*, OECD Working Papers on Fiscal Federalism, No.15, OECD Publishing.

<sup>94</sup> See, for example, Whitney, S. (2016) *A Call for Greater Fiscal Autonomy for Our Cities*, Metro Dynamics.

in 2013, only about 2.5 per cent of taxes are set locally.<sup>95</sup> This has had the consequence of stunting growth in regional cities which lack the powers they need to invest in growth-enhancing activity such as infrastructure projects.<sup>96</sup> The devolution agenda has not yet fundamentally altered the centrally-managed nature of the fiscal framework.

The two revenue streams that do exist at local level - business rates and council tax - are subject to tight centrally-imposed parameters. Business rate retention is intended to address this: the Government has promised that, by 2020, all councils will keep 100 per cent of the growth in their business rate base. This is designed to give local authorities a greater stake in the financial returns from economic growth in their areas.

If the government is serious about generating *productivity* growth locally, it needs to consider offering cities and shires further fiscal flexibility:

- Local authorities should have full freedom to set business rates locally, including entitlements and full flexibility to adapt the rate to incentivise sector-specific growth.
- For directly-elected mayors, the proposed additional two per cent 'infrastructure premium' should be replaced with a 'productivity premium', as it may be that some areas would see more productivity benefit from other investments than infrastructure alone, such as in human capital.
- Any new responsibilities given to local authorities to accompany business rate retention should be guided by a wider strategy to create levers to drive productivity growth rather than the opportunity for Whitehall departments to pass down risky administrative burdens.

At the local level, combined authorities will need to consider the potential for pooling at least some of their business rate income. This money would be redistributed according to a formula agreed by the combined authority to support growth.

---

<sup>95</sup> Professor Tony Travers, quoted in evidence to the Communities and Local Government Select Committee, (2014) *Devolution in England: The Case for Local Government*, House of Commons.

<sup>96</sup> Aubrey, T. and Reed, A., 'Osborne's fiscal devolution must go much further to transform economic growth', Policy Network, 19 November 2015.

Such an approach would give every council in the combined authority a stake in the area's overall growth by redistributing some of the proceeds of growth from city centres to poorer peripheries. It will pool the risk of fluctuations in the business rate base. Critically, it will provide the combined authority with a substantial income stream which can be used to leverage more borrowing power.<sup>97</sup>

## INCENTIVISING PRODUCTIVITY GROWTH

While the retention of business rates growth is an important step in the direction of a more localised system, it will do little to incentivise city and county regions to drive up their productivity. Business rates are levied on the estimated market rental value of non-residential properties.<sup>98</sup>

This encourages councils to maximise the amount of floor space-heavy economic activity on their patches.<sup>99</sup> Out of town shopping centres and wholesalers which tend to generate low-paid employment are worth more to a council than a cluster of innovative new SMEs dominated by highly-skilled data scientists which might one day grow into major international businesses.

Currently, any gains in productivity are entirely captured by the national tax system, through corporation tax, income tax and VAT. This makes the UK unusual in international terms. Our more productive competitors generally give their municipalities a greater stake in productivity. For instance, France's local business tax combines a measure of floor space with a value-added profit-related measure, Germany's municipalities levy a trade tax, and US cities use a wide range of corporate and personal income taxes to capture a share of local economic growth (see Case Study 14).

---

<sup>97</sup> Aubrey, T. and Reed, A., 'Osborne's fiscal devolution must go much further to transform economic growth', Policy Network, 19 November 2015.

<sup>98</sup> Adam, S. and Miller, H., (2014) 'Business rates', in *The IFS Green Budget*, Institute for Fiscal Studies.

<sup>99</sup> McGough, L. and Bessis, H. (2015) *Beyond Business Rates: Incentivising businesses to grow*, Centre for Cities.

## CASE STUDY 14 INTERNATIONAL EXAMPLES OF LOCAL BUSINESS TAXATION FRAMEWORKS

### FRANCE<sup>100</sup>

From January 2010, the French government introduced a new form of local business tax, *Contribution Economique Territoriale* (CET), which combines a tax on property space with the 'value added' by the business. The *Cotisation Foncière des Entreprises* (CFE) is the rateable value, or 'floor space' of the business, and the *Cotisation sur la Valeur Ajoutée des Entreprises* (CVAE) is the 'value added', or how much more or less profit is made by the business per annum. The CVAE element only applies to businesses with a turnover of over €500,000, and is further capped at 80 per cent of additional turnover for companies with turnovers under €7.6 million, and at 85 per cent for companies with turnovers over €7.6 million. Departmental and regional councils levy this tax and the money raised is put into public services and the *Chambres de Commerce/Metiers*. Councils have the powers to determine the rate of tax, setting the minimum levels for CFE, which will apply for 'virtual' offices.

### GERMANY<sup>101</sup>

There are two main direct taxes on businesses in Germany: corporation tax at a federal level and trade tax at a municipal level. Corporation tax (*Körperschaftsteuer*) is a blanket rate of 15 per cent with a solidarity surcharge of 5.5 per cent on top of this. Trade tax (*Gewerbesteuer*) is levied by municipalities and therefore varies from local authority to local authority. The taxable income of the company

<sup>100</sup> See Robert, E. (2010) France - The French Local Business Tax Reform: Myth and Reality, *European Taxation*, 2010 (Volume 50), No 8, IBFD; <http://www.french-property.com/guides/france/working-in-france/starting-a-business/other-business-taxes/>; <http://www.afigec.com/data/en/pdf/46/Contribution-Economique-Territoriale-CET-the-new-business-licence-tax.pdf> [accessed May 2016].

<sup>101</sup> <http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Germany-Corporate-Taxes-on-corporate-income>; <http://www.somanscheller.de/2012/02/local-german-business-tax/>; <http://www.gtai.de/GTAI/Navigation/EN/Invest/Investment-guide/The-tax-system/Company-taxation/trade-tax.html#7048>; <http://www.openpr.com/pdf/205222/German-Local-Trade-Tax.pdf>; <http://www.gtai.de/GTAI/Navigation/EN/Invest/Investment-guide/The-tax-system/value-added-tax-vat.html> [all accessed May 2016].

is multiplied with the uniform national tax base rate (3.5 per cent). This tax base amount is then multiplied with the corresponding municipal multiplier; this results in the sum total of trade tax which is due. Multipliers are set by municipalities and are between 7 and 17 per cent of business profits. Urban areas tend to have higher trade tax levies than rural areas, with the major cities operating a trade tax between 14 and 17 per cent, and it can form a large proportion of local government revenue. All entrepreneurs and companies carrying out business or trade activities are subject to this tax.

## USA<sup>102</sup>

Businesses in the USA pay a mixture of taxes at federal, state and local levels. Federal corporation tax is set at 35 per cent, which is 10 per cent higher than the OECD average of 25 per cent, and businesses are required to pay employment taxes like social security, federal income tax and federal unemployment tax. At a state level, taxes levied include general sales and use tax on inputs, corporate net income tax, unemployment insurance, excise taxes on business inputs, individual income tax, business license tax, insurance premium tax, severance taxes, public utility tax, and property tax on business property. Specifically, local taxes include property taxes on business property, general sales taxes on business inputs, public utility taxes, excise taxes on business inputs, and other business taxes including local corporate income taxes. Sales taxes are administered on a state level, except in five states which have no levy; and localities within 37 states can also administer their own sales taxes leaving a very complicated picture. On a state and local level, tax laws vary. Most states levying their own corporate income tax; for example, New Hampshire levy a Business Enterprise Tax which is predicated on the 'value added'; Ohio, Washington and Texas levy local corporation tax predicated on gross receipts; and Oklahoma use a franchise tax based on rate of capital invested in the state.

---

<sup>102</sup> McGough, L. and Bessis, H. (2015) *Beyond Business Rates: Incentivising businesses to grow*, Centre for Cities; [http://www.ey.com/Publication/vwLUAssets/EY-total-state-and-local-business-taxes-october-2015/\\$FILE/EY-total-state-and-local-business-taxes-october-2015.pdf](http://www.ey.com/Publication/vwLUAssets/EY-total-state-and-local-business-taxes-october-2015/$FILE/EY-total-state-and-local-business-taxes-october-2015.pdf); <https://www.usa.gov/business-taxes>; <https://www.salestaxhandbook.com/local-salestax-map> [all accessed May 2016].

Although standard practice amongst our international peers, the principle of greater fiscal devolution to encompass wider revenue streams is in very early days in the UK. Northern Ireland is to be granted control of corporation tax revenues, although this is less from a principle of subsidiarity and more because of the need to compete with the Republic's 12.5 per cent rate. In Scotland, a new ability to change thresholds and rates of the devolved income tax, and control over half of VAT levied in the country are being handed to the Scottish Parliament.

The government has tentatively accepted the principle of giving councils a greater stake in local growth through the Earnback and Gainshare deals included in some devolution and growth deals, but these remain an extremely limited form of fiscal devolution. Current moves towards creating a slightly more decentralised fiscal system for England need to continue, and over time go much further. There are two principles which should guide this process.

First, that devolved taxes should reward additionality. They should provide a sharp incentive for cities and shires to add to the country's overall economic growth through start-ups and foreign investment, rather than encouraging councils to shuffle existing economic activity around the country. Second, new devolved taxes should be designed to create a virtuous cycle of growth in places. They should ensure that if more of the proceeds of growth are captured locally, then this money is used to reinvest in creating and sustaining a positive environment in which to do business.

We believe that a new approach to devolving corporation tax would achieve both of these critical goals, providing councils with the incentives they need to deliver productive growth and sustainably expand the British economy. Productivity growth is, unsurprisingly, positively related to company profits, making corporation tax a reasonable proxy for productive growth.<sup>103</sup> Moreover, more profitable companies are more likely to invest in capital and practices which increase productivity in the future.

---

<sup>103</sup> Stierwald, A (2009) *Determinants of Firm Profitability – The Effect of Productivity and its Persistence*, University of Melbourne.

## A NEW MODEL: DEVOLVING CORPORATION TAX

**To create new incentives to drive productivity locally, a third of corporation tax generated in England, up to £12.1 billion, should be devolved to city and county regions.** This figure is based on the total on-shore corporation tax receipts in England in 2014-15 of £36.4 billion.<sup>104</sup> A proportion of the existing revenue stream would be allocated to combined authorities operating in devolution deals,<sup>105</sup> based on an estimate of a third of the corporation tax generated in the area. This means that exact allocations would be calculated on an individual basis and adjusted annually.

**The devolution of a share of corporation tax receipts would create direct incentives for combined authority governance across a place to take decisions that support productivity growth.** It would establish a link between productive output gains and local decision-making which would focus local governance directly on measures to create an environment in which high value growth is stimulated. This would mean in practice that local governance has a direct stake in business scale-up and generating in-work productivity. By allocating the devolved revenue stream to the combined authority, this will support strategic economic governance across a functional geography to develop to deliver the priority to drive productivity growth.

**Devolving a third of corporation tax would bring English local finance systems more in line with their international peers,** who each have elements of local incentives to boost firm profitability inherent in their models of local business taxation. It would also create a significant revenue stream against which the combined authority should have the power to borrow. This would create economic levers available to these authorities in line with the way competitors across Europe and the US finance local investment.<sup>106</sup>

---

<sup>104</sup> HM Revenue and Customs (2015) *A disaggregation of HMRC tax receipts between England, Wales, Scotland & Northern Ireland: Methodology Note*.

<sup>105</sup> In some instances, for example in the unitary authority of Cornwall and London Boroughs, combined authorities do not exist but devolution deals are in place, and so specific arrangements would need to be made for the devolution of the revenue stream.

<sup>106</sup> Aubrey, T. and Reed, A., 'Osborne's fiscal devolution must go much further to transform economic growth', Policy Network, 19 November 2015.

## WHAT IS CORPORATION TAX?<sup>107</sup>

Corporation Tax is a direct tax charged on the profits made by companies. It makes up approximately eight per cent of the total receipts collected by HMRC. The current rate of the tax is set at 20 per cent. The Budget in March 2016 announced that this rate will be cut to 17 per cent in 2020.

Corporation tax reliefs are available, in some cases linked to actions that promote productivity, such as capital allowances if companies invest in assets such as equipment or machinery, or R&D Relief.

Devolving a third of corporation tax would not alter the national rate at which the tax is levied, which would remain at the same level across the country. Therefore this measure would not result in rate competition between areas, or in additional taxation for businesses. The government has committed to reduce the current rate to 17 per cent by 2020, so the devolved pot would fall in line with that, but any future reductions to the revenue should be made in consultation with local government. As with proposed business rates localisation, there would be important distributional questions to address as a consequence of the nationally unbalanced economy, whereby some areas better placed through circumstance, geography and history to support an increase in productive output.

Some might argue that such a change to the system would be costly in itself, that assigning corporation tax to local areas will be hard and that avoidance of the tax will be high. Yet this is not in itself a reason not to pursue the devolution of corporation tax – any measure of fiscal devolution will involve a change to the current status quo. Rather than begin with the short-term logistical challenge, we need to take the starting point of what new incentives devolution would create, so that we can secure additionality to the system over the medium to long-term.

---

<sup>107</sup> See <https://www.gov.uk/corporation-tax/overview> [accessed May 2016].

Devolution of an element of corporation tax would clearly require national government to relinquish a share of its own funds. Corporation tax makes up approximately eight per cent of HM Revenue and Customs total receipts.<sup>108</sup> So the maximum devolved amount on the table for devolution would be under three per cent of central government's income. Devolving a third of the tax would be designed to boost business profitability and national productivity overall, which would bring wider benefits to the Treasury. There would be potential knock-on effects on other nationally-retained revenues such as income tax from more jobs and higher wages and VAT through increased and higher value transactions.

If the government were to assign such a substantial share of national revenues to the local level, it would clearly also want to devolve new responsibilities to combined authorities. There are several obvious areas which could be further devolved to soak up the new money generated by corporation tax. As we identify in this report, to support labour productivity, councils should be able to have accountability over, and budgets for, further education and employment advice services. These would all support local efforts to build human capital, further boosting productivity and business profits.

---

<sup>108</sup> HM Revenue and Customs (2015) *Analyses of Corporation Tax receipts and liabilities document*.

# CONCLUSION

**We hope to start a discussion about the focus of the Government's approach to local growth. Instead of relentlessly pushing for higher overall GVA by any means necessary, ministers should now shift their emphasis to encouraging the kind of growth that is most likely to deliver sustained prosperity for citizens. This ultimately requires higher productivity. Once the government has accepted this principle, it needs to focus on new ways to incentivise local government to drive productive growth.**

With a new wave of directly-elected mayors due to be elected in May 2017, the next phase of devolution must continue to remove constraints on local government's ability to respond to local economic conditions and stimulate growth.

Functional devolution of powers needs to be designed to create levers to drive productivity gains by addressing skills deficits and mismatches; creating an environment in which businesses have the support they need to make productivity gains, and in which decisions over housing, infrastructure and connectivity all support productive growth.

By giving local authorities a share of corporation tax – a fiscal link to business activity present in many of our international peers – the Government can catalyse a different relationship between local government and businesses. Local decision-making over place development would be strongly incentivised to support a diversity of business growth from small to medium to larger, and boost profitability overall.

A rebalanced economy can only emerge from a rebalanced system of local taxation, reversing decades of centralisation which have blocked cities and shires from becoming masters of their own economic destiny.

# iMPOWER

**iMPOWER is the leading public service reform consultancy. iMPOWER works with a range of public services to solve complex social problems through changing behaviours. The public sector is all about people delivering services to people, which is why behaviours and relationships are so important.**

iMPOWER uses behavioural insight to understand how and why citizens and institutions act the way that they do. Through uncovering these hidden truths, we take our partners beyond traditional service models to redesign sustainable public services from the bottom-up with citizens and users at the heart of design and delivery.

For more information, please visit [www.impact.co.uk](http://www.impact.co.uk)

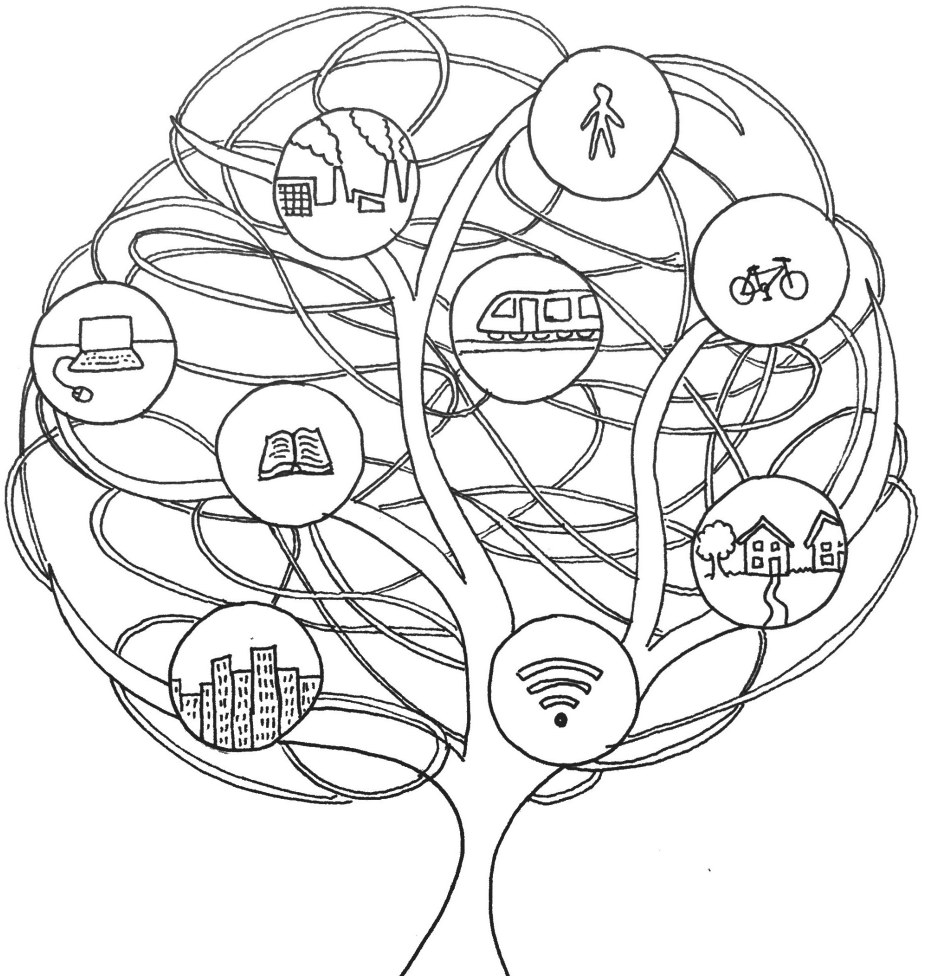
# KIER

**Kier Group plc is a leading property, residential, construction and services group that invests in, builds, maintains and renews the places where we work, live and play. We operate across a range of sectors including defence, education, health, housing, industrials, power, transport and utilities. Listed on the London Stock Exchange, we are a constituent of the FTSE 250 Index.**

With a head office at Tempsford Hall in Bedfordshire and a network of 88 UK offices Kier offers national coverage across all of its core activities. Employing 24,000 people, with a turnover in excess of £4 billion and an order book of £9 billion, Kier has the financial strength and technical expertise to undertake some of the most significant construction, civil engineering and service contracts in the country.

For more information, please visit [www.kier.co.uk](http://www.kier.co.uk)





**The UK is a productivity laggard. The effectiveness with which our businesses convert resources into goods and services is historically poor by international standards and has flatlined since the recession. Economists term this trend a “puzzle” because the causes are mysterious. But many focus only on national or sectoral level explanations and responses.**

As local government assumes an increasingly active role in local growth through devolution, how can we ensure this growth increases the value of outputs, not just the volume? We need our local economies to work smarter, not harder.

This report sets out a new framework for local productivity to address how partners in a place can drive productive growth, so that local prosperity can increase, to the benefit of local people and businesses.

*Kindly supported by:*

